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The Expropriation of Environmental Governance

Protecting Foreign Investors at the Expense of Public Policy

ACADEMISCH PROEFSCHRIFT

ter verkrijging van de graad Doctor aan
de Vrije Universiteit Amsterdam,
op gezag van de rector magnificus
prof.dr. L.M. Bouter,
in het openbaar te verdedigen
ten overstaan van de promotiecommissie
van de faculteit der Aard- en Levenswetenschappen
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door

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prof.dr. J. Gupta

The Expropriation of Environmental Governance

Protecting Foreign Investors at the Expense of Public Policy

Summary

What do a Canadian ban on the exportation of hazardous wastes, California's remediation requirements for open-pit mines, and the Municipality of Lima's closure of a pasta factory have in common? They are all government measures that have been the subject of investor-state disputes resolved in international investment arbitration. The ability of foreign investors, as private actors in global politics, to sue a state in an international forum is a significant development in both international relations and international law. It challenges many of the common assumptions of traditional theories in both disciplines and has profound implications for the future of state sovereignty. Nevertheless, this phenomenon had garnered very little attention in academic or policy circles until recently.

Investors gain access to international investment arbitration through clauses in state contracts (agreements negotiated directly between an investor and a state) and international investment agreements (IIAs) (agreements negotiated between two or more states which provide protection for investors hailing from one state party and operating in the territory of another state party). The most common form of IIA is the bilateral investment treaty (BIT). The first known BIT was signed in 1959 between West Germany and Pakistan, but it is only recently that these agreements have proliferated. By the end of 2005, nearly 2500 BITs had been signed. Investment protection provisions can also be found in more than 230 regional trade and economic cooperation agreements.

Over the last decade, there has been an explosive increase of cases of investment arbitration. As of November 2006, the cumulative number of all known treaty-based investor-state disputes was 255 and at least 70 governments had faced investment arbitration. However, it is not only the number of disputes that have

arisen and the number of states that have been involved that is noteworthy. The novel *types* of dispute that have emerged are also significant. Rather than solely involving straightforward incidences of nationalization or breach of contract, the new generation of disputes often revolve around public policy measures and implicate sensitive issues such as access to drinking water, development on sacred indigenous sites, and the protection of biodiversity.

This study explores the implications of investment arbitration for one particularly topical area of public policy: the protection of the environment. The existing literature on the relationship between investment protection and environmental protection is generally written either from the perspective of investment lawyers, who often overlook many issues that are critical to the effective regulation of the environment, or from the perspective of environmental lawyers who are not always adequately versed in the highly specialized field of investment law. This study aims to fill this scholarly lacuna by providing a more comprehensive treatment of both investment law and environmental regulation. Furthermore, it adds a distinctly *political* dimension to a topic that often remains within the purview of legal studies. The guiding theoretical approach in the study is drawn mainly from international relations/international political economy scholarship, and particularly from critical studies of globalization that adopt a neo-Gramscian perspective.

Problem Definition and Research Question

Over the last two decades, the mantra that foreign direct investment (FDI) is vital in the effort to reduce the gap between wealthy and poor nations has become pervasive in international policy discussions. FDI is also increasingly touted as a key ingredient for the achievement of *sustainable development*. However, despite the uncritical approach to FDI found in many international organizations and think tanks, academic debate on the investment-development nexus is longstanding and unresolved. When the discussion is shifted to incorporate the social and environmental concerns that make up the more recent and amorphous concept of sustainable development, it is unsurprising that an academic consensus on the costs and benefits of FDI has failed to emerge.

Some scholars argue that foreign firms will use clean(er) technology and adopt

home country standards or international best practices in their operations, and that positive spillovers to the domestic arena will result. Others point out that while foreign companies may be familiar with high standards and have access to state-of-the-art technology, it is too optimistic to assume that they will automatically adopt best practices in their operations in every country. Furthermore, it has been argued that even if foreign firms are relatively cleaner they are also generally larger than their domestic counterparts in developing countries, and thus have the potential to make an overall greater environmental impact.

While the debate over the relationship between sustainable development and FDI continues, it would appear that one broadly accepted conclusion that has emerged is that the *regulatory context* in which the investment is situated is critical. In the absence of binding global rules on corporate conduct, the national level remains the primary site for the regulation of foreign investment. However, when domestic regulation negatively impacts an investment, for example by increasing operating costs, conflicts between a foreign investor and the host state may emerge. If an investor is protected by a state contract or IIA, he may respond to such a conflict by initiating, or threatening to initiate, investment arbitration proceedings. Such actions may, in turn, have short-term and long-term implications for environmental governance.

This study examines the outcome of several cases of investor-state conflict over environmental policy. In addition to analysing the pleadings of parties and decisions of arbitral tribunals in disputes that have been resolved in arbitration, the influence that investment arbitration has had in negotiated outcomes to conflicts is also explored. While conflicts in developed countries are discussed, a special focus is given to the issues and concerns that are specific to the developing world.

Against this backdrop, the overarching research question of the study is:

What implications does the protection of foreign investment through international investment agreements and state contracts have for environmental governance, particularly in developing countries?

The Institution of Investment Protection

The constitutive, regulative, and procedural norms and rules that are found in state contracts, IIAs, and sets of arbitral rules, collectively make up what is described

in this study as the *transnational institution of investment protection*. This is a hybrid public-private institution that operates simultaneously at the international, national, and subnational levels. While the norms and rules are primarily generated by public actors (states), private actors (arbitrators) are delegated the authority to ‘interpret’ and apply these rules to specific disputes. Furthermore, private actors (foreign investors) are constituted as de facto subjects of international law capable of independently bringing a claim against a state. An investor can claim that measures taken by any level of government (municipal, provincial, etc.) are in conflict with the rules and norms of the institution, although it is ultimately the national government that assumes liability and will have to defend the measures in arbitration.

In environmentally relevant disputes, the pertinent regulative norms and rules are those covering national treatment, most-favoured-nation treatment, the international minimum standard/fair and equitable treatment, expropriation, performance requirements, stability of host country law, and observance of obligations (umbrella clauses). Procedural norms and rules concern the formation of tribunals, the conduct of arbitral proceedings, and the production and distribution of arbitral awards.

The regulative norms and rules of investment protection are decidedly vague and open to a significant degree of interpretation. There is the clear potential for environmental policy or court proceedings on environmental matters to be interpreted as conflicting with these norms and rules. However, the emergence and outcome of disputes remains difficult to predict given the broad scope for interpretation and the absence of any system of precedent. Serious procedural issues, including the lack of transparency and accountability in investment arbitration, compound this uncertainty. Furthermore, particular challenges exist for developing countries, which lack the financial and technical resources to deal with complex and costly arbitral proceedings.

Investor-State Disputes

To date a number of conflicts between investors and states related to environmental policy have been resolved in arbitration. These disputes have concerned a wide range of regulatory actions and several different environmental issues (e.g. haz-

ardous waste, biodiversity, air/water pollution). Disputes in Canada, Costa Rica, Mexico, Peru, and the United States are discussed in the first part of the empirical portion of the study.

The decisions made by arbitral tribunals in these cases are inconsistent. Although the circumstances of each case differ substantially, this alone does not account for the divergence in tribunal decisions. This is not to claim that the circumstances of a case are immaterial, but only to suggest that the viewpoints and perspective of arbitrators are also relevant. This makes the outcome of cases more difficult for states to predict. However, despite the inconsistencies, several trends in arbitral practice are identifiable. First of all, tribunals are not likely to accept a state's purported reasons for adopting an environmental measure on its face, but will instead assess the measure's *legitimacy*. In this respect, science plays an important role, but the *precautionary principle* appears to be absent from the reasoning of tribunals. Another significant development is the growing acceptance of *positive obligations* of investment protection. Thus, protecting investment no longer solely requires a state to refrain from taking certain actions; it also mandates compliance with *good governance* principles such as transparency and predictability.

The cases also indicate that investment protection could potentially have consequences for *multilevel governance*. While investment arbitration is only accessible to national governments, a great deal of responsibility for the regulation of the environment in both developed and developing countries is delegated to sub-national levels of government. This dichotomy could lead to conflict between levels of government and efforts to re-centralize power. Investment protection may also affect the implementation of multilateral environmental agreements, requiring governments to take measures that are least inconsistent with investment protection, perhaps at the expense of the efficiency and effectiveness of environmental regulation.

The Threat of Arbitration

While most research on the relationship between investment law and environmental law and policy focuses on disputes that are resolved in international arbitration, many conflicts between investors and states will likely never reach this

stage. Arbitration is a high-risk, high-cost option for both governments and investors. Furthermore, states are concerned with the effect that formal disputes may have on their reputation as investor-friendly hosts. The second part of the empirical portion of the study makes a significant contribution to the literature by providing a detailed examination of investor-state conflicts that were resolved without recourse to arbitration, but where the existence of investment protection nevertheless played an important role in the outcome. Conflicts between investors and states concerning both environmental policy (in Ghana, Indonesia, and Costa Rica) and domestic court proceedings (in Indonesia and Ecuador) are assessed. The analysis focuses on the role that the threat of arbitration played in the outcome of each conflict.

Some of the cases suggest that the existence of investment protection adds a new dimension to the *regulatory chill* hypothesis, which originally emerged in the context of the pollution havens debate. In addition to concerns about the exit of investors ('industrial flight'), governments may also be wary of improving environmental regulation because of concerns that they will face costly arbitration as a result. At the other end of the spectrum, some of the cases suggest that governments might use the existence of commitments to investment protection as an excuse or *political cover* for its failure to improve environmental regulation. In this respect, it is important to consider the internal politics in the government, particularly in light of the fact that investment agreements are negotiated by different ministries (economic, foreign affairs) than those that deal directly with the protection of the environment. Finally, the cases concerning environmental liability show that in addition to influencing government behaviour, investment protection also has the potential to influence the decisions of domestic courts (*judicial chill*).

A Period of Change

The period over which this study was conducted was one of rapid development in the field of investment law and arbitration practice. The substantial increase in the use of investment arbitration has led to greater scrutiny of the regulative and procedural norms and rules of investment protection, and in some cases, to a re-evaluation of the purpose and function of these rules and norms. States, arbitral supervisory bodies, arbitrators, and NGOs have all played a role in bringing about

change.

The most dramatic changes have occurred in the procedures of investment arbitration. Many arbitral awards are now made publicly available, and *amicus curiae* submissions to tribunals are becoming more frequent. Some countries, particularly Canada and the United States, have also revised their model BITs and have taken up the practice of conducting environmental impact assessments of new investment agreements. However, these changes are largely cosmetic and fail to address the key issues of accountability, predictability, and the capacity of developing countries to handle disputes. Furthermore, the involvement of NGOs in the arbitration process may only serve to lend the institution of investment protection an unmerited air of legitimacy.

More substantial proposals for reform, such as the development of an appellate body or a multilateral investment agreement for sustainable development, are also limited in both scope and viability. In particular, it is unlikely in the current political climate that a multilateral agreement on investment - sustainable or not - could be negotiated.

Many countries appear to be unwilling to wait for the institution of investment protection to change, and instead have decided to opt out of it. However, the backlash against investment protection will only have implications for environmental governance if it is uniform, and not restricted to disputes over the economic returns from natural resource exploitation.

The Expropriation of Environmental Governance

With the advent of the institution of investment protection, and with the expansion of substantive norms and rules within this institution to cover aspects of environmental protection, elements of environmental governance have been taken over, or *expropriated*, by international arbitral tribunals. Arbitrated outcomes may be positive or negative from the perspective of the parties to the dispute, but the larger issue is whether tribunals should be granted the authority to *regulate the regulators*.

The expropriation of environmental governance by arbitral tribunals has led, or will lead, to a *loss of democratic accountability* in environmental decision-making. It is acceptable in democratic countries for domestic courts to check

the power of the legislature, because the judiciary is considered reasonably free from political influence. On the other hand, as a governance system, investment arbitration is fundamentally undemocratic and its neutrality is questionable. The procedural rules and norms of investment protection were established to deal with commercial disputes where confidentiality was considered paramount, and consistency irrelevant. Such a system is inappropriate when states are involved in disputes and especially when sensitive issues of public policy, such as environmental regulation, are at stake.

The institution of investment protection has also shifted a significant degree of the risk that is inherent in foreign investment from investors to host states and has created considerable *uncertainty for regulators*. The regulative rules and norms of investment protection are ambiguous, and vary in their specific wording from treaty to treaty. When arbitral tribunals attempt to throw light upon the meaning of these rules and norms, their interpretations are controversial and inconsistent. Transparency is increasing, but confidentiality is still ubiquitous, making it more difficult for states to evaluate how disputes have been treated in arbitration. When the outcome of arbitration is uncertain, states that are faced with a threat of arbitration are more likely to settle, often at the expense of public policy.

Finally, the institution of investment protection will lead to a *decrease in the amount, and/or the effectiveness, of environmental policy* in host states. Investment protection dictates how and when states are to exert control over investors, and places limits the number of tools in the ‘policy toolbox’. Furthermore, in addition to directly castigating states, arbitrators also influence regulators and judges. Just as any good judicial system will prevent as well as punish crime, the system of investment arbitration dissuades regulatory or judicial misconduct by states. The problem is that it may also deter policy development and court proceedings that are in the interests of the public good.

Special Issues for Developing Countries

Developing countries sign the vast majority of IIAs and state contracts, and yet these countries are often poorly prepared to negotiate international agreements. In addition to signing more agreements, developing countries are often the only parties with real obligations under IIAs. In theory, inter-state investment agree-

ments are reciprocal in that they require each state party to protect the investors of each other state party when they are operating within their territory. However, this theoretical reciprocity is not sustained in practice. This is because in the majority of investment agreements, state parties are asymmetrically related in terms of investment flows; that is, one state in the relationship exports capital, while the other(s) import capital. This is the case whether the agreement is between a developed country and one or more developing countries or economies in transition, as is the case in that majority of agreements, or if it is between two or more transition/developing economies. Instances of agreements between capital-exporting states are rare, and developed countries are not frequently exposed to investor claims.

With respect to the protection of the environment, developing countries are likely to face more investor-state conflicts than their developed counterparts because: environmental policy is more likely to *change* and to change more rapidly, leading to conflicts (there is a lower baseline level of regulation and considerable pressure to ‘catch-up’ with international standards); there is less *coherence* in national policy and thus a higher likelihood of conflicts arising between policies developed to protect investors and policies developed to protect the environment; there is a higher instance of *corruption* and thus investors may be given greater concessions that may in turn lead to conflicts in the future and; the *courts* are less respected and trusted and therefore court proceedings are more likely to be challenged for lack of due process. Furthermore, when conflicts arise it is more likely that they will be resolved in, or influenced by, investment arbitration than when comparable conflicts arise in developed countries because developing countries: have made more *commitments* to investment protection; cannot as easily absorb the *costs* of arbitration (both financial and reputational); and have a lower *capacity* to deal with disputes.

One could nevertheless conclude that an increase in investor-state conflicts is an acceptable trade-off for the benefits of increased flows of FDI. However, establishing a causal connection between the conclusion of an IIA and increased foreign investment flows is notoriously difficult and this issue remains highly contested in the literature. Furthermore, any gains made by developing countries in attracting investment through IIAs will be largely at the expense of other developing countries, because the system is based on competition, and thus overall welfare will not

improve even if specific flows increase. Additionally there is the question of the actual benefit to the host state of increased inflows of foreign investment if they do materialize. In particular, there is the issue of the value of foreign investment in the form that is promoted in IIAs and state contracts, given the fact that these agreements seem to emphasize the encouragement of foreign investment as if it were an *end in itself*, rather than a means to achieving sustainable development.

Contribution to Theory

The institution of investment protection is viewed in this study as a key component of what neo-Gramscians call the ‘new constitutionalism’. The new constitutionalism encompasses the structural and ideological constraints that are imposed on states by a transnational historic bloc made up of corporate and governmental elites. The concept helps to explain why states are voluntarily ceding authority to tribunals and it also captures the way in which the constraints of investment protection can be ‘locked-in’, resulting in a loss of democratic accountability.

The study benefited from the application of neo-Gramscian insights and it also, in turn, contributed to neo-Gramscian scholarship. While the major writings in the field are largely focused at the macroeconomic and macropolitical level, this study focused on one specific area and gave considerable attention to domestic interactions. The study also drew links between neo-Gramscian theory and other theories/hypotheses (e.g. regulatory chill, political cover). These hypotheses and theories are consistent with neo-Gramscian thought and both enrich and help to operationalize a neo-Gramscian framework.

Recommendations

Absent the creation of an entirely new mechanism of investor-state dispute settlement, such as an investment court, it would seem that the most sensible option for governments is to restrict access to arbitration to states only, and provide investors recourse to only domestic remedies. In addition to (or in lieu of) avoiding the current system of investment arbitration, reference to the international minimum standard/fair and equitable should not be included in new IIAs. The standard is simply too broad and has been interpreted too expansively by tribunals. Further-

more, state contracts, if they are to be employed by states, should not include stabilization clauses. Given the fact that in many developing countries environmental regulation of foreign investment is minimal to begin with, agreeing to general or specific commitments to stability of the environmental regulatory framework could lock a country into deteriorating environmental conditions.

When drafting IIAs and state contracts, governments should ensure that it is explicitly stated that the purpose of these agreements is to promote and protect investment that contributes to sustainable development. However, considering the amorphous nature of this concept, governments should also incorporate in the text of IIAs the most important and relevant principles of international environmental law. Additionally, states should increase transparency and participation in contract and treaty negotiation. Developing countries should also make efforts to cooperate to a greater extent on investment issues to avoid the bidding wars that competition for investment can create. Finally, international organizations, research institutions, lawyers, NGOs, and states should collaborate to create a legal assistance centre for developing countries.

De Onteigening van Milieubestuur

Bescherming van buitenlandse investeerders ten koste van overheidsbeleid

Samenvatting

Wat hebben een Canadees exportverbod op gevaarlijk afval, Californische herstelverplichtingen voor de dagmijnbouw en de sluiting van een pastafabriek in Lima met elkaar gemeen? Dit zijn voorbeelden van overheidsmaatregelen die leidden tot geschillen tussen investeerders en overheden in internationale investeringsarbitrage. Dat buitenlandse investeerders de nationale overheid van een staat kunnen dagen voor een internationaal tribunaal is een zeer belangrijke ontwikkeling voor internationale betrekkingen en in het internationaal recht. Het gaat in tegen de heersende veronderstellingen in beide disciplines en kan verstrekkende gevolgen hebben voor de toekomst van de soevereiniteit van de staat. Toch heeft dit fenomeen tot voor kort weinig aandacht gekregen in academische en beleidskringen.

Investeerders hebben middels twee wegen toegang tot internationale arbitrage: via bepalingen in overheidscontracten (overeenkomsten tussen een investeerder en de nationale overheid) en via internationale investeringsverdragen (overeenkomsten tussen staten waarbij bescherming wordt geboden voor investeerders die opereren op het grondgebied van een andere staat). De meest voorkomende vorm van internationale investeringsverdragen is het bilaterale investeringsverdrag. Het eerste bilaterale investeringsverdrag werd in 1959 gesloten tussen West-Duitsland en Pakistan. Het aantal verdragen is recentelijk sterk gegroeid: eind 2005 waren er al bijna 2500 verdragen afgesloten. Daarnaast kunnen internationaal-rechtelijke bepalingen over investeringsbescherming ook teruggevonden worden in de meer dan 230 regionale handels- en economische samenwerkingsverdragen.

In de afgelopen tien jaar is er een explosieve groei geweest in het aantal gevallen van investeringsarbitrage. In november 2006 waren er 255 gevallen van conflicten tussen investeerders en overheden bekend, waarbij ten minste 70 verschillende landen waren gedaagd. Naast de toename van het aantal geschillen en betrokken overheden is er een opvallende ontwikkeling in het *soort* geschillen dat ontstaat. Het gaat namelijk niet meer alleen om geschillen over nationalisering of contractbreuk, maar vaak om maatregelen van overheidsbeleid over gevoelige kwesties zoals de toegang tot drinkwater, ontwikkeling op heilige plaatsen en de bescherming van biodiversiteit.

Dit proefschrift verkent de gevolgen van investeringsarbitrage voor een belangrijk beleidsonderwerp: milieubescherming. Auteurs die zelf uit de hoek van het investeringsrecht komen en rapporteren over de relatie tussen de bescherming van investeringen en milieubescherming, gaan vaak voorbij aan kwesties die van wezenlijk belang zijn voor effectieve milieuregelgeving. Daartegenover zijn milieujuristen niet altijd voldoende op de hoogte van de ingewikkelde kwesties in het internationale investeringsrecht. Dit proefschrift heeft als doel deze wetenschappelijke lacunes te vullen door middel van een uitgebreide behandeling van zowel investerings- als milieurecht. Daarnaast voegt het een specifieke politieke dimensie toe aan een onderwerp dat vaak slechts behandeld wordt door rechtsgeleerden. De voornaamste theoretische benadering voor dit proefschrift komt voort uit de studie van internationale betrekkingen en de studie van internationale politieke economie. In het bijzonder wordt voortgebouwd op kritische studies over globalisering waarin een neo-Gramsciaans perspectief wordt gehanteerd.

Probleemstelling en Onderzoeksvraag

In de laatste twee decennia is de opvatting dat directe buitenlandse investeringen van fundamenteel belang zijn bij het verminderen van de kloof tussen arme en rijke landen diep doorgedrongen in internationale beleidskringen. Directe buitenlandse investeringen worden ook gezien als een belangrijk aspect voor het bereiken van *duurzame ontwikkeling*. Hoewel de benadering van directe buitenlandse investeringen in internationale organisaties en denktanks veelal wordt gezien als kritiekloos, is er een hevig academisch debat gaande over de relatie tussen investeringen en ontwikkeling. Nu deze discussie tevens de sociale en milieuaspecten van

het vage concept van duurzame ontwikkeling raakt, is het niet geheel verrassend dat er geen academische consensus is over de kosten en baten van directe buitenlandse investeringen.

Sommige wetenschappers betogen dat buitenlandse ondernemingen schone(re) technologieën gebruiken en de hoge standaarden van het thuisland en de internationaal beste geldende praktijken overnemen, wat zal leiden tot hoogwaardige investeringen in het gastland. Anderen wijzen er juist op dat hoewel buitenlandse ondernemingen bekend zijn met deze hoge standaarden en toegang hebben tot de nieuwste technologieën, het te optimistisch is te veronderstellen dat deze praktijken daadwerkelijk worden toegepast in het land waarin ze opereren. Daarnaast wordt betoogd dat zelfs wanneer buitenlandse bedrijven schoner werken, zij zodanig groter in omvang zijn dan binnenlandse ondernemingen dat ze potentieel een grotere indruk op het milieu teweegbrengen.

Hoewel het debat over de relatie tussen duurzame ontwikkeling en directe buitenlandse investeringen nog volop gaande is, lijkt het er op dat het alom aanvaard is dat de *regelgevende context* van de investeringen van wezenlijk belang is. Aangezien er geen bindende internationale regels zijn voor het gedrag van multinationale ondernemingen blijft het nationale beleid het belangrijkste voor de regulering van buitenlandse investeringen. Wanneer nationale wetgeving nadelige gevolgen heeft voor investeringen, bijvoorbeeld door het verhogen van de kosten van de bedrijfsvoering, kan het tot een conflict komen tussen de buitenlandse investeerder en het gastland. Als een investeerder beschermd wordt door een overheidscontract of een internationaal investeringsverdrag kan hij reageren door het starten van een internationale arbitrageprocedure - of het dreigen daarmee. Zulke acties kunnen op hun beurt gevolgen hebben voor milieubestuur op de korte en de lange termijn.

Dit proefschrift is een analyse van de resultaten van een aantal geschillen tussen overheden en investeerders op het gebied van milieubeleid. De pleidooien van partijen en beslissingen van arbitragepanelen in een aantal geschillen zijn hiervoor bestudeerd. Tevens wordt gekeken naar de invloed van investeringsarbitrage op schikkingen. Hoewel geschillen in ontwikkelde landen ook worden besproken, wordt er in het bijzonder aandacht geschonken aan kwesties die van belang zijn voor ontwikkelingslanden.

Tegen deze achtergrond is de overkoepelende onderzoeksvraag van dit proef-

schrift:

Wat zijn de gevolgen van investeringsbescherming door middel van internationale investeringsverdragen en overheidscontracten voor milieu-bestuur, met name in ontwikkelingslanden?

De Praktijk van Investeringsbescherming

De constitutieve, regelgevende en procedurele normen die gevonden kunnen worden in overheidscontracten, internationale investeringsverdragen en arbitrageregels vormen samen de *transnationale praktijk van investeringsbescherming*. Dit is een hybride publiek-private praktijk die zich tegelijkertijd afspeelt op het internationale, nationale en lokale niveau. Hoewel de normen met name afkomstig zijn van publieke actoren (overheden), hebben private actoren (arbiters) de bevoegdheid om deze normen te interpreteren en toe te passen op specifieke gevallen. Daarnaast zijn andere private actoren (buitenlandse investeerders) de rechtssubjecten die bevoegd zijn om een klacht tegen een staat in te dienen. Een investeerder kan stellen dat bepaalde (lokale of nationale) overheidsmaatregelen in strijd zijn met de normen van het investeringsrecht. Uiteindelijk kan de nationale overheid aansprakelijk worden gesteld en dient het de maatregelen in de arbitrage te verdedigen.

In milieugerelateerde geschillen zijn de voornaamste regels het vereiste van nationale behandeling, het “most-favoured-nation treatment” beginsel, de verplichting van de internationale minimumstandaard/redelijke en billijke behandeling, onteigening, prestatievereisten, stabiliteitsbepalingen, en het nakomen van verplichtingen (de zogeheten paraplu-bepaling). Procedurele regels betreffen de samenstelling van tribunalen, de uitvoering van de arbitrageprocedure en het opstellen en verspreiden van arbitrale uitspraken.

De normen op het gebied van investeringsbescherming zijn vaag en kunnen op zeer verschillende wijzen worden genterpreteerd. Er is een niet geringe kans dat milieubeleid of juridische beslissingen over het milieu worden gezien als in strijd zijnde met deze normen. Het blijft moeilijk te voorspellen hoezeer deze geschillen zich voordoen en wat hun uitkomst zal zijn gezien de ruime interpretatiemogelijkheden en het ontbreken van een precedentensysteem. Belangrijke procedurele

kwesties, waaronder het gebrek aan openheid en verantwoordingsmogelijkheden in investeringsarbitrage, vergroten deze onzekerheid. Daarnaast zijn er specifieke moeilijkheden voor ontwikkelingslanden, die niet de financiële en technische middelen hebben om met ingewikkelde en dure arbitrageprocedures om te gaan.

Geschillen tussen Investeerders en Overheden

Inmiddels is een aantal geschillen tussen investeerders en overheden met betrekking tot milieubeleid beslecht door middel van arbitrage. Deze geschillen hadden betrekking op een verscheidenheid aan overheidsmaatregelen en milieukwesties (bijvoorbeeld gevaarlijk afval, biodiversiteit en lucht- en watervervuiling). Geschillen in Canada, Costa Rica, Mexico, Peru en de Verenigde Staten worden besproken in het eerste deel van het empirische gedeelte van dit proefschrift.

De uitspraken van arbitragetribunalen in deze kwesties zijn niet consequent. De variatie in de uitspraken van de tribunalen kan niet geheel verklaard worden door de verschillende omstandigheden van iedere zaak. Daarmee wil niet gezegd worden dat de specifieke omstandigheden er niet toe doen, maar wel dat ook de persoonlijke standpunten van arbiters een rol lijken te spelen. Dit zorgt ervoor dat de uitkomst van de geschillen moeilijk te voorspellen is voor overheden. Niettemin kunnen bepaalde ontwikkelingen in de arbitragepraktijk onderscheiden worden. Ten eerste zullen tribunalen niet snel de motivatie van een staat voor milieumaatregelen klakkeloos overnemen, maar met name kijken naar de legitimiteit van een maatregel. Om deze reden speelt de wetenschap een belangrijke rol, maar het voorzorgsbeginsel lijkt geen belangrijke rol te spelen in de motivering van tribunalen. Een tweede belangrijke ontwikkeling is de toenemende aanvaarding van positieve verplichtingen op het gebied van investeringsbescherming. Het beschermen van investeringen vereist dus niet alleen dat staten afzien van bepaalde activiteiten, maar verplicht ze ook om beginselen van behoorlijk bestuur, zoals openheid en voorspelbaarheid, na te leven.

De geschillen geven ook een aanwijzing dat de bescherming van investeringen mogelijk gevolgen heeft voor het bestuur op verschillende niveaus. Hoewel alleen nationale overheden partij kunnen zijn in arbitrageprocedures, ligt de verantwoordelijkheid voor milieubeleid in zowel ontwikkelde als ontwikkelingslanden in grote mate bij lokale overheden. Deze tweedeling zou tot botsingen tussen ver-

schillende overheidsniveaus kunnen leiden, alsmede tot pogingen van de nationale overheid om de macht weer naar zich toe te trekken. Investeringsbescherming kan tevens de tenuitvoerlegging van internationale milieuverdragen beïnvloeden omdat van overheden verwacht wordt dat ze maatregelen nemen die zo min mogelijk gevolgen hebben voor investeringsbescherming, ook al gaat dat ten koste van de effectiviteit van milieubeleid.

De Dreiging van Arbitrage

Alhoewel het meeste onderzoek over de relatie tussen milieu- en investeringsrecht zich toespitst op geschillen die beslecht worden door international arbitrage, is het waarschijnlijk dat veel geschillen tussen investeerders en staten dit stadium niet eens bereiken. Arbitrage brengt hoge risico's en kosten met zich mee voor zowel overheden als investeerders. Daarnaast zijn overheden bezorgd over de gevolgen van geschillen voor hun reputatie als gastland voor investeerders. Het tweede deel van het empirische gedeelte van het proefschrift levert een belangrijke bijdrage aan de literatuur door een gedetailleerde analyse te geven van geschillen tussen investeerders en overheden die nooit zijn beslecht door arbitrage, maar waar investeringsbescherming niettemin een belangrijke rol speelde in de uiteindelijke uitkomst. Geschillen tussen investeerders en overheden over milieubeleid (in Ghana, Indonesië en Costa Rica) en nationale rechtsprocedures (in Indonesië en Ecuador) worden doorgelicht. De analyse richt zich op de rol die de dreiging van arbitrage speelt bij de uitkomst van een geschil.

Sommige gevallen wijzen erop dat investeringsbescherming een nieuwe dimensie geeft aan de “regulatory chill” hypothese. Naast zorgen over het vertrek van investeerders kunnen overheden ook afzien van het verbeteren van milieuwetgeving vanwege de kosten van mogelijke arbitrageprocedures. Andere gevallen suggereren weer dat overheden het bestaan van hun verplichtingen op het gebied van investeringsbescherming als een rechtvaardiging gebruiken voor het gebrek aan verbeterd milieuregelgeving. Daarom is het belangrijk om de binnenlandse politiek mee te nemen in de analyse, met name omdat investeringsverdragen worden afgesloten door andere ministeries (economische en buitenlandse zaken) dan de ministeries die direct betrokken zijn bij milieubescherming. Tenslotte laten de gevallen die betrekking hebben op milieuaansprakelijkheid zien dat investerings-

bescherming niet alleen overheidsbesluiten beïnvloedt, maar ook de beslissingen van de rechterlijke macht (“judicial chill”).

Een Overgangsperiode

De periode waarin het onderzoek voor dit proefschrift is uitgevoerd werd gekenmerkt door een snelle ontwikkeling op het gebied van investeringsrecht en de arbitragepraktijk. De aanzienlijke toename van het gebruik van investeringsarbitrage heeft geleid tot meer toezicht op de materiele en procedurele regels met betrekking tot investeringsbescherming en, in enkele gevallen, tot een heroverweging van het doel en de functie van deze regels. Overheden, arbitrale overzichtsorganen, arbiters en niet-gouvernementele organisaties hebben allemaal een rol gespeeld bij het totstandkomen van deze veranderingen.

De meest ingrijpende veranderingen hebben plaatsgevonden op het gebied van arbitrageprocedures. Veel uitspraken worden inmiddels openbaar gemaakt, en steeds vaker worden er “amicus curiae briefs” ingediend bij tribunalen. Sommige landen, zoals Canada en de Verenigde Staten, hebben hun model voor bilaterale investeringsverdragen aangepast en beoordelen nu ook de milieueffecten van nieuwe investeringsverdragen. Deze veranderingen betreffen echter niet de belangrijke kwesties van verantwoording, voorspelbaarheid en de capaciteit in ontwikkelingslanden voor het omgaan met geschillen. Daarnaast kan het betrekken van niet-gouvernementele organisaties zorgen voor een ongerechtvaardigde legitiemer van de praktijk van investeringsbescherming.

Andere hervormingsvoorstellen, zoals het instellen van een beroepsorgaan of het onderhandelen van een multilateraal investeringsverdrag voor duurzame ontwikkeling zijn ook beperkt in reikwijdte en politieke vatbaarheid. In het huidige politieke klimaat is het onwaarschijnlijk dat een multilateraal investeringsverdrag gesloten kan worden - duurzaam of niet.

Veel landen lijken niet te willen wachten totdat de praktijk van investeringsbescherming verandert en hebben er voor gekozen om er niet meer aan deel te nemen. Deze weerstand zal echter alleen maar gevolgen hebben voor milieubestuur als het eenduidig is en niet slechts beperkt blijft tot geschillen over de inkomsten van het gebruik van natuurlijke hulpbronnen.

De Onteigening van Milieubestuur

Met de opkomst van de praktijk van investeringsbescherming en de uitbreiding van bijbehorende normen die betrekking hebben op het milieu worden onderdelen van milieubestuur overgenomen, of beter gezegd *onteigend*, door internationale arbitragetribunalen. Arbitrale uitkomsten kunnen zowel voor- als nadelig zijn vanuit het perspectief van de deelnemende partijen, maar de meer essentiële vraag is of tribunalen de bevoegdheid zouden moeten krijgen om de regels te maken waar regelgevers zich aan zouden moeten houden.

De onteigening van milieubestuur door arbitragetribunalen heeft geleid, of zal leiden tot een verlies van democratische verantwoording in de besluitvorming over milieukwesties. Het is algemeen aanvaard in democratische landen dat rechters de wetgever controleren, aangezien de rechterlijke macht gezien wordt als onafhankelijk van politieke invloeden. In vergelijking hiermee is investeringsarbitrage als een bestuursstelsel fundamenteel ondemocratisch en kan de neutraliteit van dit stelsel in twijfel getrokken worden. De procedurele regels van investeringsbescherming zijn vastgesteld om met commerciële geschillen om te gaan waarbij vertrouwelijkheid van groot belang is en consistentie niet relevant. Dit stelsel is niet geschikt voor geschillen waarin staten betrokken zijn en waar gevoelige kwesties van overheidsbeleid, zoals milieubeleid, op het spel staan.

De praktijk van investeringsbescherming heeft ook in belangrijke mate geleid tot een verschuiving in wie het risico draagt voor buitenlandse investeringen. In plaats van de investeerders ligt dit risico nu meer bij de gastlanden, wat zorgt voor onzekerheid bij overheden. De normen van investeringsbescherming zijn niet eenduidig en de bewoording verschilt per verdrag. Wanneer arbitragetribunalen de betekenis van deze normen proberen te verduidelijken zijn de interpretaties vaak controversieel en inconsistent. Hoewel de openheid is toegenomen, is geheimhouding nog de norm. Dit maakt het lastig voor overheden om te beoordelen hoe geschillen behandeld worden in arbitrageprocedures. Als de uitkomst van dreigende arbitrage onzeker is, zullen overheden sneller een minnelijke schikking zoeken, wat vaak weer ten koste gaat van het overheidsbeleid.

Tenslotte zal de praktijk van investeringsbescherming leiden tot een vermindering van de hoeveelheid en de effectiviteit van het milieubeleid in de gastlanden. Investeringsbescherming bepaalt hoe en wanneer staten controle kunnen

uitoefenen op investeerders en beperkt de beleidsruimte. Daarnaast beïnvloeden arbiters de wetgevers en rechters in het gastland. Zoals ieder rechtssysteem misdaad voorkomt en bestraft, zo zorgt het systeem van investeringsarbitrage er voor dat staten afzien van wangedrag door wetgevers en rechters. Het probleem is echter dat het ook overheidsbeleid en rechterlijke beslissingen in het algemeen belang kan afschrikken.

Specifieke Kwesties voor Ontwikkelingslanden

Landen in de Derde Wereld zijn betrokken bij het grootste gedeelte van de internationale investeringsverdragen en overheidscontracten, terwijl zij vaak slecht zijn voorbereid op het onderhandelen van internationale verdragen. Daarnaast zijn ontwikkelingslanden ook vaak de enige partijen die echte verplichtingen op zich nemen in dit soort verdragen. Theoretisch zijn interstatelijke investeringsverdragen wederkerig in de zin dat ze van alle deelnemende staten vereisen dat ze investeerders uit een andere staat beschermen wanneer deze op hun grondgebied opereren. Deze theoretische wederkerigheid geldt echter niet in de praktijk, omdat in de meeste gevallen staten niet dezelfde positie hebben met betrekking tot investeringsstromen: waar de ene staat kapitaal uitvoert, voert een andere staat kapitaal in. Dit is het geval wanneer het een verdrag betreft tussen een ontwikkeld land en één of meer ontwikkelingslanden of landen met een overgangseconomie, zoals in het merendeel van de verdragen, of wanneer het gaat om verdragen tussen ontwikkelingslanden of landen met een overgangseconomie. Verdragen tussen kapitaaluitvoerende staten zijn zeldzaam en ontwikkelde landen worden dus niet vaak gedaagd door investeerders.

Het is waarschijnlijker dat ontwikkelingslanden verzeild raken in geschillen over milieubescherming in vergelijking met ontwikkelde landen om de volgende redenen: 1) milieubeleid is meer onderhevig aan (snelle) veranderingen, wat kan leiden tot geschillen (bij gebrek aan milieubeleid is er aanzienlijke druk om internationale standaarden in te halen); 2) er is minder samenhang in nationaal beleid en daarmee dus een grotere kans op interne strijdigheid tussen het beleid om investeerders te beschermen en het beleid ter bescherming van het milieu; 3) er is een hogere mate van corruptie waardoor er meer concessies gedaan worden aan investeerders, wat weer kan leiden tot mogelijke toekomstige geschillen;

en 4) de rechterlijke macht wordt minder gerespecteerd en vertrouwd, waardoor rechterlijke uitspraken sneller kunnen worden betwist bij gebrek aan een behoorlijke procesgang. Daarnaast is het belangrijk dat als geschillen zich voordoen, het waarschijnlijker is dat deze worden opgelost of beïnvloed door investerings-arbitrage in vergelijking met geschillen in ontwikkelde landen omdat: ontwikkelingslanden meer verplichtingen op zich hebben genomen om investeringen te beschermen; minder mogelijkheden hebben om de kosten van geschillen op zich te nemen (zowel op financieel gebied als met betrekking tot de reputatie); en minder capaciteit hebben om met geschillen om te gaan.

Desondanks kan geconcludeerd worden dat een toename in geschillen tussen investeerders en overheden aanvaardbaar is in verband met de voordelen van grotere investeringsstromen. Het is echter zeer moeilijk om een causaal verband vast te stellen tussen het afsluiten van internationale investeringsverdragen en een toename in directe buitenlandse investeringsstromen en de literatuur blijft verdeeld over deze kwestie. Daarnaast gaan de voordelen die behaald worden door ontwikkelingslanden als gevolg van het binnenhalen van investeringen grotendeels ten koste van andere ontwikkelingslanden. Dit kan verklaard worden doordat het een op concurrentie gebaseerd systeem betreft. Dit betekent dat de algemene welvaart niet zal verbeteren, zelfs als bepaalde investeringsstromen toenemen. Daarnaast is het de vraag of de voordelen van de buitenlandse investeringen ook daadwerkelijk gerealiseerd worden. Internationale investeringsverdragen en overheidscontracten lijken er van uit te gaan dat het bevorderen van buitenlandse investeringen op zichzelf het doel is, in plaats van een middel om duurzame ontwikkeling te realiseren.

Bijdrage aan Theorievorming

De praktijk van investeringsbescherming wordt in dit proefschrift gezien als een belangrijk onderdeel van het neo-Gramsciaanse “new constitutionalism”. Dit concept omvat de structurele en ideologische beperkingen voor overheden, die door een transnationale historische bedrijfs- en overheidselite zijn opgelegd. Met behulp van dit concept kan worden uitgelegd waarom overheden vrijwillig de bevoegdheid aan tribunalen overlaten. Tevens kan hiermee worden verklaard hoe de beperkingen van investeringsbescherming voortduren, met als gevolg een vermin-

dering van de democratische verantwoording.

Dit proefschrift heeft baat gehad bij de toepassing van neo-Gramsciaanse inzichten en heeft tegelijkertijd bijgedragen aan de neo-Gramsciaanse wetenschap. Waar de belangrijkste bijdragen op dit gebied zich geconcentreerd hebben op het macro-economische en macropolitieke niveau, heeft dit proefschrift zich op een bepaald studiegebied gericht en veel aandacht geschonken aan nationale interacties. Het proefschrift legt ook relaties tussen neo-Gramsciaanse theorieën en andere theorieën en hypothesen (zoals “regulatory chill”). Deze hypothesen en theorieën komen overeen met het neo-Gramsciaanse gedachtengoed en helpen om het neo-Gramsciaanse kader te verrijken en te operationaliseren.

Aanbevelingen

Bij gebrek aan nieuwe mechanismen om geschillen tussen investeerders en overheden te beslechten, zoals de instelling van een investeringsrechtbank, lijkt het er op dat de meest verstandige optie is om de toegang tot arbitrage te beperken tot overheden en geschillen met investeerders te laten beslechten door nationale rechtsmiddelen. Daarnaast zouden verwijzingen naar de internationale minimumstandaard/redelijke en billijke behandeling niet opgenomen moeten worden in nieuwe internationale investeringsverdragen. De standaard is simpelweg te ruim en is ook zo genterpreteerd door tribunalen. Daarnaast dienen overheidscontracten geen stabiliseringsbepalingen te bevatten. Omdat in veel ontwikkelingslanden de milieugerelateerde regulering van buitenlandse investeringen minimaal is, kan het overeenkomen van dit soort bepalingen de milieuwetgeving van een land blokkeren, leidend tot verslechterde milieuomstandigheden.

Bij het ontwerpen van internationale investeringsverdragen en overheidscontracten dienen overheden er voor te zorgen dat duidelijk wordt gemaakt dat het doel van die overeenkomsten is om *duurzame* investeringen te bevorderen en te beschermen. Gezien het vage karakter van het concept van duurzame ontwikkeling, is het nodig dat overheden de belangrijkste en meest relevante beginselen van internationaal milieurecht in internationale investeringsverdragen opnemen. Daarnaast moeten overheden bij het afsluiten van contracten en verdragen openheid van zaken geven en participatie bevorderen. Ontwikkelingslanden dienen tevens meer samen te werken op het gebied van investeringskwesties in plaats

van met elkaar te concurreren voor investeringen. Tenslotte zouden internationale organisaties, onderzoeksinstanties, juristen, niet-gouvernementele organisaties en overheden moeten samenwerken om een rechtshulporganisatie voor ontwikkelingslanden op te zetten.

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Acronyms and Abbreviations

AAA	American Arbitration Association
ADELA	Acción de Lucha Anti-Petrolera (Costa Rica)
ADM	Archer Daniels Midland
ASCM	Agreement on Subsidies and Countervailing Measures
ASEAN	Association of Southeast Asian Nations
BCSD	Business Council for Sustainable Development
BIT	bilateral investment treaty
CAA	Commercial Arbitration Act (Canada)
CAFTA-DR	Central America-Dominican Republic-United States Free Trade Agreement
CBD	Convention on Biological Diversity
CEC	Commission on Environmental Cooperation
CERDS	Charter of Economic Rights and Duties of States
CIEL	Center for International Environmental Law
CoW	contract of work
DCF	discounted cash flow
DPR	House of Representatives (Indonesia)
ECGD	Export Credits Guarantee Department (UK)
EDC	Export Development Canada
ECHR	European Court of Human Rights
ECJ	European Court of Justice
ECOSOC	Economic and Social Council (UN)
EA	environmental assessment

EIA	environmental impact assessment
EPA	Environmental Protection Agency
EU	European Union
FAO	Food and Agricultural Organization
FCN	friendship, commerce and navigation treaty
FDI	foreign direct investment
FOE	Friends of the Earth
FIPA	Foreign Investment Promotion and Protection Agreement (Canada)
FTA	free trade agreement
FTAA	Free Trade Area of the Americas
FTC	Free Trade Commission (NAFTA)
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GPA	Agreement on Government Procurement
IAIGC	Inter-Arab Investment Guarantee Corporation
ICAA	International Commercial Arbitration Act (Canada)
ICC	International Chamber of Commerce
ICSID	International Centre for the Settlement of Investment Disputes
IFC	International Finance Corporation
IIA	international investment agreement
IISD	International Institute for Sustainable Development
ILA	International Law Association
ILM	International Legal Materials
ILO	International Labour Organization
IMF	International Monetary Fund
INE	National Ecology Institute (Mexico)
ISO	International Organization for Standardization
ITO	International Trade Organization
IUCN	International Union for the Conservation of Nature
JATAM	Mining Advocacy Network (Indonesia)
JOA	joint operating agreement
LCIA	London Court of International Arbitration

MAI	Multilateral Agreement on Investment (OECD)
MEA	multilateral environmental agreement
MIGA	Multilateral Investment Guarantee Agency
MINAE	Ministry of Environment and Energy (Costa Rica)
MMT	methylcyclopentadienyl manganese tricarbonyl
MNC	multinational corporation
MNE	multinational enterprise
MTBE	methyl tertiary butyl ether
NAAEC	North American Agreement on Environmental Cooperation
NAFTA	North American Free Trade Agreement
NBV	net book value
NGO	non-governmental organization
NIEO	New International Economic Order
NRDC	Natural Resources Defense Council
NWO	Netherlands Scientific Organisation
OECD	Organisation for Economic Cooperation and Development
OEEC	Organisation for European Economic Cooperation
OPIC	Overseas Private Investment Corporation
PCB	polychlorinated biphenyl
PROFEPA	Federal Attorneys Office for the Protection of the Environment (Mexico)
RECIEL	Review of European Community and International Environmental Law
SCC	Stockholm Chamber of Commerce
SEC	Securities and Exchange Commission
SETENA	Environmental Agency (Costa Rica)
TDR	third party dispute resolution
TNC	transnational corporation
TPA	Trade Promotion Authority Act (US)
TRIMs	Trade-Related Investment Measures
TRIPs	Trade-Related Intellectual Property Rights
UN	United Nations
UNCED	United Nations Conference on Environment and Development
UNCHE	United Nations Conference on the Human Environment

UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNCTC	United Nations Center on Transnational Corporations
UNDP	United Nations Development Program
UNEP	United Nations Environment Program
UNFCCC	United Nations Framework Convention on Climate Change
UK	United Kingdom
UPS	United Parcel Service
US	United States
USTR	United States Trade Representative
WALHI	Friends of the Earth Indonesia
WBCSD	World Business Council for Sustainable Development
WCED	World Commission on Environment and Development
WHO	World Health Organization
WICE	World Industrial Council for the Environment
WSSD	World Summit on Sustainable Development
WTO	World Trade Organization

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Introduction

What do a Canadian ban on the exportation of hazardous wastes, California's remediation requirements for open-pit mines, and the Municipality of Lima's closure of a pasta factory have in common? They are all government measures that have been the subject of investor-state disputes resolved in international investment arbitration. The ability of foreign investors, as private actors in global politics, to sue a state in an international forum is a significant development in both international relations and international law. It challenges many of the common assumptions of traditional theories in both disciplines and has profound implications for the future of the state sovereignty. Nevertheless, this phenomenon had garnered very little attention in academic or policy circles until recently.

Over the last decade, there has been an explosive increase of cases of investment arbitration as a result of the rapid proliferation of international investment agreements which provide legal protection to foreign investors. This is significant, not only in terms of the number of disputes that have arisen and the number of states that have been involved, but also with a view to the novel *types* of dispute that have emerged. Rather than solely involving straightforward incidences of nationalization or breach of contract, the new generation of disputes often revolve around public policy measures and implicate sensitive issues such as access to drinking water, development on sacred indigenous sites, and the protection of

biodiversity.

This study explores the implications of investment arbitration for one particularly topical area of public policy: the protection of the environment. This subject is addressed through an analysis of the outcome of several conflicts which arose between investors and states as a result of either the introduction of new environmental regulations or the initiation of domestic court proceedings related to corporate liability for environmental damage.

The existing literature on the relationship between investment protection and environmental protection is generally written either from the perspective of investment lawyers, who often neglect many issues that are critical to the effective regulation of the environment, or from the perspective of environmental lawyers who are not always adequately versed in the highly specialized field of investment law. This study aims to fill this scholarly lacuna by providing a more comprehensive treatment of both investment law and environmental regulation. Furthermore, it adds a distinctly political dimension to a topic that often remains within the purview of legal studies. The guiding theoretical approach in the study is drawn mainly from international relations/international political economy scholarship, and particularly from critical studies of globalization that adopt a neo-Gramscian perspective.

This chapter provides an introduction to the relationship between foreign investment and sustainable development. It explains the various strategies available to investors when they are faced with a conflict with a host state, and reviews the existing literature on the most widely studied strategy of *exit* ('industrial flight'). It then addresses the alternative strategy of *voice*. With this discussion as a backdrop, the problem definition and overarching research question of the study are presented. The chapter concludes with a discussion of the methodology employed in the empirical portion of the study.

1.1 Background

Foreign investment can be defined as, "[t]he transfer of tangible or intangible assets from one country into another for the purpose of their use in that country

to generate wealth under the total or partial control of the owner of the assets.”¹ This definition encompasses both foreign direct investment (FDI), the transfer of physical property, and ‘portfolio investment’ which involves only the movement of money through the purchase of shares in foreign corporations.²

Policy-makers, international development organizations and scholars have emphasized the importance of FDI in reducing the global gap between wealthy and poor nations.³ FDI flows have rapidly increased in recent history, and while downturns have periodically occurred, on average FDI flows have multiplied more rapidly than trade flows.⁴ While still largely concentrated in the ‘triad’ of Western Europe, North America and Japan, the share of FDI flows directed to developing countries has increased in the last decade.⁵ However, this fact masks the reality that only a small group of developing countries - particularly China, Mexico, Singapore, Malaysia, and Brazil - are really benefiting from these increased flows while other countries, particularly those in sub-Saharan Africa, are increasingly marginalized.⁶ Nevertheless, it would seem that the increases in investment flows, despite their uneven distribution, have strengthened the belief among many developing countries that FDI can be beneficial to development and can help reduce resource, technology, and foreign exchange gaps.⁷

FDI is also increasingly considered a key ingredient for achieving *sustainable*

¹Sornarajah 2004a, at 7.

²*Ibid.* Portfolio investment composes an increasingly large share of global flows of investment, but this study focuses on FDI which has a greater potential to contribute to development.

³For example, see the Monterrey Consensus of the International Conference on Financing for Development, 18-22 March 2002, Monterrey, Mexico, <http://www.un.org/esa>. See also the series of World Investment Reports produced annually by the United Nations Conference on Trade and Development (UNCTAD), <http://www.unctad.org>.

⁴Cohn 2004, at 313.

⁵This study adopts the categorizations provided by UNCTAD which identifies ‘developed’ areas as Western Europe, North America, and ‘other’ (Australia, Israel, Japan, Malta, New Zealand). ‘Developing areas and territories’, on the other hand, include Africa, East, South and South-East Asia (excluding Japan), West Asia (excluding Israel), Central Asia, Latin America and the Caribbean, and the Pacific (excluding Australia and New Zealand). Central and Eastern Europe are categorized separately as ‘economies in transition’.

⁶Cohn 2004, at 325.

⁷Mosoti 2005, at 95.

development.⁸ For example, Cosbey *et al.* argue that sustainable development requires structural economic change, which can only be brought about by investment, and in developing countries this is most likely to come in the form of foreign (rather than domestic) investment.⁹ In fact, they attest that it is “hard to overstate the importance of investment for sustainable development.”¹⁰

Unlike some forms of economic activity, FDI is generally long-term in nature, which is important for sustainable development.¹¹ FDI can also facilitate technology transfer, which can be crucial for mitigating environmental damage.¹² For example, in discussions on climate change there has been considerable emphasis on the role that foreign investment can play in enabling developing countries to ‘leapfrog’ to the use of modern technologies in order to reduce greenhouse gas emissions.¹³ In addition to the fact that foreign companies generally have greater access to clean(er) technology, they are also familiar with higher standards (home country standards or international best practices), and they are more likely to want to retain a positive reputation internationally through corporate social responsibility initiatives. Foreign investors may even be required by the institutions financing their foreign investment projects to meet certain standards or take certain measures, such as conducting an environmental impact assessment (EIA). This leads many commentators to conclude that domestic investors are in general ‘dirtier’ than foreign ones.

Nevertheless, it is also widely recognized that foreign investment can cause significant environmental degradation in host countries. In particular, there is the ‘scale impact’ of FDI, which means that even if foreign firms are relatively cleaner they are also generally larger than their domestic counterparts, and thus have the potential to make an overall greater environmental impact.¹⁴ In some sectors, such as mining, only foreign companies will have the resources required to carry

⁸Sustainable development is defined by the World Commission on Environment and Development (WCED) 1987, at 43, as “development which meets the needs of the present without compromising the ability of future generations to meet their own needs.”

⁹Cosbey *et al.* 2004, at v.

¹⁰*Ibid.*, at 1. See also: Mann 2003, at 248; von Moltke 2002b, at 145; Zarsky 2000, at 2.

¹¹Cosbey *et al.* 2004, at 1.

¹²OECD 1997, at 6-7.

¹³See generally Hedger *et al.* 2000; Mansley *et al.* 2000.

¹⁴Zarsky 1999.

out large-scale projects in small developing countries, often in remote areas that otherwise would remain pristine.¹⁵ Furthermore, while foreign companies may be familiar with high standards and have access to state-of-the-art technology, as Gallagher and Zarsky note, the assumption that investors will automatically adopt best practices for their operations in every country is “too optimistic.”¹⁶

The only overarching conclusion that has emerged from research on the relationship between foreign investment and the environment appears to be that *context* is important.¹⁷ Particularly relevant is the regulatory context in which the investment is situated. As Peterson argues:

Foreign investment is most likely to contribute to sustainable development in contexts where governments are free to regulate and/or tax that investment so that it can be harnessed to domestic policy objectives such as social services, environmental protection, poverty-alleviation or the provision of other public goods - at the same time that investors enjoy sufficient certainty that they can invest under predictable terms.¹⁸

1.1.1 Protecting Foreign Investment

As there is not an unlimited supply of foreign investment that is equally distributed around the world, it is often argued that states must compete for FDI, and one of the ‘necessary conditions’ to create an ‘attractive’ or ‘friendly’ investment climate is the existence of adequate legal protection for investors.¹⁹ Foreign investment is inherently risky, and investors perceive risk as particularly high in developing countries.²⁰ Foreign investors tend to distrust the local legal systems in many countries to protect them from unjustified interference in their operations by the

¹⁵Cléménçon 2000, at 209

¹⁶Gallagher and Zarsky 2007, at 30.

¹⁷Brooks *et al.* 2004, at 8; Mann and Araya 2002, at 164; Cléménçon 2000, at 219; Subedi 1998, at 415.

¹⁸Peterson 2004b, at 7-8.

¹⁹Vagts 1987, at 2, explains that the concept of an ‘investment climate’ is “in effect, a way of expressing the level of risk of adverse future governmental action which present or potential foreign investors perceive as existing in the nation in question.”

²⁰Head 2007, at 477.

government. Consequently, political risk may hinder flows of investment to the countries that need it the most.

The purported solution to this problem has been the creation of agreements that govern the relationship between investors and governments and shift dispute resolution out of local courts and into international arbitration. Traditionally, investment was mainly protected through investor-state agreements, variously referred to in the literature as ‘host government agreements’, ‘economic development agreements’, or ‘state contracts’. State contracts are still used extensively in developing countries, especially in the natural resource sectors, and are given particular attention in this study. However, in addition to state contracts, which cover only specific investments, protection can also be more generally provided through international agreements. While there is no multilateral agreement on investment, regional and sectoral agreements, as well as bilateral investment treaties (BITs) are abundant.²¹ In this study, agreements negotiated between two or more states concerning the protection of investors hailing from one country party (the ‘home state’) when that investor operates in another country party (the ‘host state’) are collectively referred to as international investment agreements (IIAs). IIAs may be stand-alone agreements, or they may be only one part of a broader trade or economic cooperation agreement.

IIAs outline requirements for the state that is *hosting* investment. While IIAs are reciprocal (with each state able to act as a ‘home’ and ‘host’ to investors) the asymmetry of investment flows that often exists between parties to an IIA means that, in practice, only one state has real obligations under the agreement. For example, imagine that an agreement is signed between State A and State B: on the one hand, State A is an exporter of capital, with investors operating in State B; on the other hand, State B is primarily an importer of capital, and has no investors operating in State A. In this scenario, only State B has categorical obligations.

²¹ Regional investment agreements cover many sectors and involve more than two states bound within a geographic area. Sectoral agreements cover only one sector of investment (e.g., energy) but involve more than two states. Finally, bilateral investment treaties (BITs) involve only two states. It should be noted that the Energy Charter Treaty, which contains a chapter on investment, is a significant sectoral investment agreement, but it is not discussed further in this study. For a discussion of the Energy Charter Treaty with specific reference to the relationship between investment protection and environmental protection see Chalker 2006; Wälde 1998b.

Developing countries, with a few notable exceptions (e.g., Brazil, China, India, and Malaysia) are, at present, primarily importers and not significant exporters of capital.²²

Whether the protection of foreign investment through IIAs is, in fact, responsible for increased flows of FDI to the developing world is a topic of much scholarly debate. Empirically, there are examples that raise doubts about the effect of IIAs. For example, Brazil is a recipient of a large amount of FDI and yet has not ratified any BIT.²³ Conversely, many African countries that have ratified numerous BITs remain marginalized in terms of global investment flows. This is consistent with the mixed anecdotal evidence of investor awareness of, and interest in, IIAs.²⁴

In recent years, several studies have attempted to prove statistical correlation, or lack thereof, between IIAs and investment flows. Franck divides these studies into those which represent a ‘market protagonist’ view (IIAs have a minor impact on FDI and market forces are far more critical determinants of flows), and those that take a ‘treaty protagonist’ stance (IIAs play an important role in attracting FDI).²⁵ One study, conducted by a World Bank economist, falls into the former category.²⁶ Hallward-Driemeier assessed twenty years of FDI flows from Organization for Economic Cooperation and Development (OECD) countries to developing countries and found that there is little evidence that BITs have stimulated additional investment.²⁷ Tobin and Rose-Ackerman, in a 2004 study, also found the relationship between BITs and FDI to be weak.²⁸ However, in 2006 the same authors reported that they had developed a more sophisticated model and concluded, in contradiction with their previous results, that BITs do have a positive impact on FDI flows to developing countries.²⁹ Nevertheless, Tobin and Rose-Ackerman qualify this finding by noting that the impact of BITs is highly dependent on the

²²Mosoti 2005, at 97.

²³Newcombe 2007a, at 372.

²⁴Franck 2007, at 347-8.

²⁵*Ibid.*, at 349.

²⁶Hallward-Driemeier 2003.

²⁷For another study reaching similar conclusions, see UNCTAD 1998.

²⁸Tobin and Rose-Ackerman 2005.

²⁹Tobin and Rose-Ackerman 2006.

political and economic environment in the host country.³⁰ Furthermore, they suggest that as the global coverage of BITs increases, the marginal effect of one country's BITs on its FDI inflows will decline.³¹ In a more overtly treaty protagonist study, Neumayer and Spess critique Hallward-Driemeier's methodology (as well as that employed by others) and argue that BITs do live up to their purported purpose of fostering FDI flows.³² Other studies have also come to this conclusion, though they have at times produced conflicting results. For example, Salacuse and Sullivan found that if a country signed a BIT with the United States (US) it would receive more FDI from that country, whereas Gallagher and Birch found that the total number of BITs signed by a country can be positively correlated to greater FDI flows, but that specifically signing a US BIT had no impact on inflows of US FDI.³³

Unlike the vast majority of research on investment agreements in political science, the problem to be addressed in this study is not the attraction of FDI. While the extent that IIAs live up to their purported purpose is certainly a critical issue, it is not possible to incorporate this complex and potentially intractable debate into this study.³⁴ Instead the focus is on the challenges that governments face in terms of regulating foreign investment in this new 'enabling' legal environment; a subject scarcely touched on in the literature to date.³⁵

1.1.2 Protecting the Environment

Regulating foreign investment has been a key concern of countries, particularly in the developing world, for the last half century. In the last thirty years, the issue of regulating foreign investment for the protection of the environment has

³⁰ *Ibid.*, at 4.

³¹ *Ibid.*

³² Neumayer and Spess 2005.

³³ Salacuse and Sullivan 2005; Gallagher and Birch 2006.

³⁴ Vandevelde 1998, at 524, suggests that, "[i]t is unlikely that any causal connection between the conclusion of BITs and increased foreign investment flows could ever be established using statistical correlations."

³⁵ IIAs and state contracts are 'enabling' in the sense that they are designed to facilitate investment by providing rights to private parties and defining the obligations of the state, but not vice versa. See Levy and Egan 1998.

become particularly prominent, as a result of both domestic opposition to environmentally damaging activities and the development of international commitments aimed at protecting the global commons and preventing transboundary environmental harm.

The focus of discussions on the international regulation of foreign investment has tended to be on transnational corporations (TNCs),³⁶ given their dominance over global investment flows³⁷ as well as their capacity to develop large-scale, and therefore potentially more environmentally-damaging, investment projects.³⁸ There are strong economic and environmental arguments both for and against the international regulation of TNCs. On the one hand, advocates argue that international rules will mitigate a series of adverse environmental effects of FDI and that without such regulation environmentally responsible countries and companies will lose competitiveness.³⁹ On the other hand, opponents suggest that international regulation is economically sub-optimal as it prevents countries from exploiting comparative advantages associated with their higher ‘assimilative capacity’ for pollution, and that there is also a danger that international rules will become a cover for protectionism.⁴⁰ Nevertheless, Hansen concludes that, on balance, international regulation of TNCs is desirable to guarantee salient environmental values and minimum standards, to compensate for regulatory failure at the national level, to encourage high environmental performance and innovation in TNCs, and to facilitate FDI in developing countries.⁴¹ With regard to the last point, Hansen suggests that international rules on TNC conduct might appease public concerns about investment projects, which can pose an obstacle to their operation, level the playing field amongst competing companies, and reduce some of the uncertainty surrounding environmental regulation in developing countries.⁴²

To date, very little has been accomplished at the international level in terms

³⁶Brewer and Young 1998, at 11, define a TNC as “an enterprise which owns (in whole or in part), controls, and manages value-adding activities in more than one country.” TNCs are also commonly referred to as multinational corporations (MNCs) or multinational enterprises (MNEs).

³⁷TNCs control approximately two-thirds of global trade and investment.

³⁸Plahe and Gaag 2000, at 229.

³⁹Hansen 2002, at 170.

⁴⁰*Ibid.*

⁴¹*Ibid.*, at 170-1.

⁴²*Ibid.*

of binding environmental standards for TNCs. In fact, as is noted in a textbook on global business law, when it comes to the regulation of foreign investors “it is probably accurate to say that mulilateral rules that are of a directly binding character are virtually nonexistent.”⁴³ Hence, unlike the legal protection of investment, the regulation of investment with a view to protecting the environment remains an issue of largely domestic purview.

1.2 Investor Strategies to Deal with Conflicts with the Host State

Increasingly, domestic environmental regulation and opposition to investment projects from communities and non-governmental organizations (NGOs) are seen as major political risks for foreign investment.⁴⁴ As such, it is ever more likely that conflicts between investors and host states will occur. For example, the imposition of a new environmental policy can be costly, particularly if the development was not anticipated by the investor and therefore was not taken into account in the cost-profit analysis that informed the decision to invest in the first place.⁴⁵ In such a situation, there are three possible strategies for an investor to pursue: to accept the environmental policy and associated costs; to relocate to another jurisdiction; or to contest the policy through lobbying, litigation, etc.⁴⁶

An investor may accept the environmental policy for a variety of reasons: it may not significantly interfere with his investment; he may be concerned with damaging his relationship with the government by ‘kicking up a fuss’; he may be aiming to improve his image as an environmental leader in the industry; or he may fear reprisals from domestic or international NGOs if he does not accept the policy. In any event, the investor’s decision to *not act* presumably has no negative implications for environmental governance.

However, the issue is far more complicated in cases where an investor *does act*. The two active strategies for investors described above - to leave the host

⁴³Head 2007, at 500.

⁴⁴Wälde 1998b, at 245; Bastida 2001, at 42.

⁴⁵Bekhechi 2001, at 86.

⁴⁶Murphy 2004, at 87.

state or to try to contest the policy - can be more succinctly termed 'exit' and 'voice' respectively. These concepts were developed by Hirschman in his analysis of the decline in firms, organizations, and states.⁴⁷ However, these concepts readily apply to conflicts between investors and states as well. One can draw a parallel between a customer who is unhappy with a change in a firm's product and an investor who is dissatisfied with a change in a host state's environmental policy. Similarly, just as customers have alternative products that they may choose to purchase if they are unhappy with a company, investors have alternative (attractive) jurisdictions that they may choose to invest in. This is especially the case in this globalized era when capital is mobile and states compete for investment, as firms do for customers.⁴⁸ The loss of customers can be damaging to a firm's profits; similarly, the loss of investors can be damaging to a state's economy.

Hirschman argues that "exit requires nothing but a clearcut either-or decision," but voice is "a far more 'messy concept' because it can be graduated, all the way from faint grumbling to violent protest."⁴⁹ Hirschman describes the difference between exit and voice as follows:

To resort to voice, rather than exit, is for the customer or member to make an attempt at changing the practices, policies, and outputs of the firm from which one buys or of the organization to which one belongs. Voice is here defined as any attempt at all to change, rather than to escape from, an objectionable state of affairs, whether through individual or collective petition to the management directly in charge, through appeal to a higher management, or through various types of actions and protests including those that are meant to mobilize public opinion.⁵⁰

The definition of voice adopted in this study follows as *any attempt by a foreign investor to change, rather than escape from, an objectionable state of affairs*.

Despite the fact that exit and voice are two distinct options, Hirschman emphasizes how they are interrelated, noting that the voice option will more likely be taken at an early stage, while the decision to exit is "taken in the light of the

⁴⁷Hirschman 1970.

⁴⁸Strange 1996, at 110.

⁴⁹Hirschman 1970, at 43 and 16.

⁵⁰*Ibid.*, at 30.

prospects for the effective use of voice.”⁵¹ In Hirschman’s view, the two categories of exit and voice “reflect more a fundamental schism: that between economics and politics. Exit belongs to the former realm, voice to the latter.”⁵² In the study of the relationship between investment and the environment, exit has been the primary focus of research, which indeed has been dominated by economic analysis. While it is voice and a political perspective that are the main interest in this study, it is worth briefly examining the substantial literature on investor exit.

1.2.1 The Exit Option

Foreign investors are generally motivated by the availability of natural resources (resource-seeking FDI), access to new markets for goods and services (market-seeking FDI), and/or cost minimization (efficiency-seeking FDI).⁵³ Thus, investors may exit a jurisdiction when resources are exhausted or when a market is too small to support production. However, it is the notion that investors will exit a jurisdiction for reasons of cost, more commonly referred to as ‘industrial flight’, that has been the subject of significant scholarly attention.

The reason for this attention is the link between cost minimization and regulation. For example, labour laws, health and safety standards, and environmental regulation all impose costs on investors. Furthermore, these standards are not harmonized across states, or even in some cases across sub-state jurisdictions (e.g., provinces). As such, it has been hypothesized that investors will leave jurisdictions with stringent regulation in favour of those with more lenient rules for efficiency reasons. This sparked concern within highly regulated jurisdictions (mainly developed countries) over potential job losses. It also led some observers to postulate that, in an attempt to keep or regain investment, countries would lower their labour, health, and environmental standards leading to a ‘race to the bottom’.⁵⁴

⁵¹ *Ibid.*, at 37.

⁵² *Ibid.*, at 15.

⁵³ Dunning 1993, cited in Caspary and Berghaus 2004, at 684.

⁵⁴ As Porter 1999, at 136, indicates, the term ‘race to the bottom’ does not imply that standards literally fall to the bottom, but only that standards are reduced to a suboptimal level and are therefore “inefficient for the entire system of jurisdictions in the sense of causing distortion in the allocation of resources.”

Pollution Havens

Research that has specifically addressed the relationship between the locational decisions of foreign investors and environmental regulation comprises the ‘pollution havens’ debate.⁵⁵ The debate is over whether or not investors will migrate to jurisdictions (e.g., developing countries) with lax environmental standards. According to Neumayer, there is a popular misconception that “any country with less strict environmental standards than one’s own country is guilty of providing a pollution haven.”⁵⁶ Neumayer argues that such a definition is inappropriate because countries cannot be expected to have the same levels of environmental regulation, particularly given the wide disparities in wealth and resources between developing and developed states. He therefore provides the following definition of a pollution haven:

A country provides a pollution haven if it sets its environmental standards below the socially efficient level or fails to enforce its standards in order to attract foreign investment from countries with higher standards or countries that better enforce their standards.⁵⁷

Similarly, according to Wheeler, “[w]hat really counts for the pollution havens debate is neither market ownership nor market location, but the willingness of the host government to ‘play the environment card’ to promote growth.”⁵⁸

By the mid-1980s, researchers had concluded that the new strict environmental regulations in developed countries had not resulted in industrial flight, and thus rejected the validity of the pollution haven hypothesis as a whole.⁵⁹ By way of explanation it was argued that environmental costs make up only a small proportion of a company’s total costs, and therefore they have little impact on a firm’s locational decisions, particularly in comparison to other factors such as the size of the domestic market or the level of infrastructure in a country.⁶⁰ Furthermore, it

⁵⁵For an overview of pollution havens literature see OCED 1997, and the special issue of *Global Environmental Politics* (vol. 2, issue 2) devoted to this topic.

⁵⁶Neumayer 2001b, at 147.

⁵⁷*Ibid.*, at 148.

⁵⁸Wheeler 2002, at 1.

⁵⁹Strohm 2002, at 31.

⁶⁰Kelemen 2004, at 289.

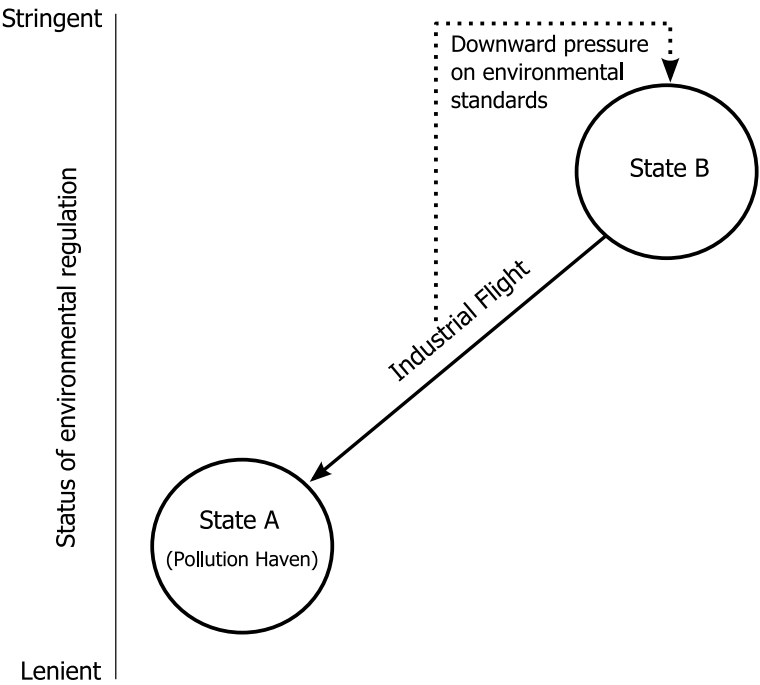


Figure 1.1: The Race to the Bottom

was suggested that governments in developed countries respond to high levels of public demand for environmental protection, which counteracts any inclination to lower standards to keep or attract investment, thus precluding a race to the bottom.

Despite the initial lack of empirical evidence, research in the area continued and recently several studies, using more sophisticated techniques, have found “statistically significant pollution haven effects of reasonable magnitude.”⁶¹ Additionally, scholars have begun to critique early pollution havens research on a number of levels.

Methodologically, observers have pointed out problems such as unobserved heterogeneity and endogeneity in early studies.⁶² However, there is also a broader criticism of the dominance of economic analysis in the field. Strohm notes that:

Economists rely on statistical information and theoretical models, often rejecting case studies as non-technical anecdotes. Environmentalists question the assumptions, omissions, and relevance of economic models, preferring instead the careful documentation of specific stories.⁶³

Clapp suggests that “[i]nstead of searching for statistical proof that pollution havens exist within the current, narrow and economic framework, a broader, more nuanced approach to the issue should be taken.”⁶⁴

In terms of the scope of the debate, it has been narrowly confined by the definition of ‘dirty industry’ adopted by most researchers. The primary focus has been on the manufacturing sector, rather than the extractive industries that make up the bulk of investment flowing to many low-income countries.⁶⁵ Neumayer notes that:

Especially in the mining and other resource extraction sectors, multinational corporations also at times do take advantage of low environmental standards in the host country - an impact on the environment that is outside the pollution haven hypothesis proper.⁶⁶

⁶¹ Brunnermeier and Levinson 2004, at 38.

⁶² *Ibid.*

⁶³ Strohm 2002, at 33.

⁶⁴ Clapp 2002, at 17.

⁶⁵ *Ibid.*, at 12, and Mabey and McNally 1998, at 11.

⁶⁶ Neumayer 2001b, at 173.

Environmental costs are also very narrowly defined. The data used to determine which sectors are highly polluting largely consists of emissions data or information on expenditures related to emission controls.⁶⁷ Habitat destruction, biodiversity loss, and numerous other environmental impacts are not captured by this limited scope. Additionally, Mabey and McNally point out that environmental assets are generally undervalued by governments:

With regulation universally low, and environmental costs representing only a small fraction of operating costs, firms' locational preferences will be less influenced by environmental standards. If external environmental costs were truly internalized the cost of compliance would increase significantly ... [and] variations in environmental regulation would become a more significant factor in a firm's choice of investment location. Therefore, empirical research cannot measure the impact of competition for FDI on environmental standards merely by searching for the existence of pollution havens.⁶⁸

The focus of the majority of pollution havens research has been restricted even further by a preoccupation with industrial flight and the concerns within developed countries about potential job losses.⁶⁹ This bias toward concern for the impact on developed countries has skewed the findings. Even if existing evidence does not support the industrial flight hypothesis, some authors argue that research indicates that environmental regulation does in fact influence some firms' locational decisions, particularly in resource and pollution-intensive sectors.⁷⁰ Moreover, while competitive pressure to attract FDI may be counteracted in developed countries where governments are responsive to high levels of demand for environmental quality, the situation may be considerably different in developing countries.⁷¹

Regulatory Chill

Many authors who are disparaging of the pollution havens debate have suggested that the regulatory chill hypothesis offers a new avenue of research. This hy-

⁶⁷Clapp 2002, at 12.

⁶⁸Mabey and McNally 1998, at 31.

⁶⁹Clapp 2002, at 11; Strohman 2002, at 29; and Mabey and McNally 1998, at 30.

⁷⁰*Ibid.*

⁷¹Porter 1999, at 134.

pothesis suggests that countries fear raising environmental standards because they *believe* that it may deter new investment or lead to industrial flight. Porter notes that:

Regardless of the empirical evidence of the impact of standards on trade competitiveness and firm location ... many officials of industrial firms as well as government officials clearly *believe* differences in environmental costs affect competitiveness and investment decisions and tend to act accordingly.⁷²

Similarly, Neumayer argues that “what really matters is what policy makers believe, not what economic theory and evidence says, and there can be no doubt that they actually do believe that countries compete with each other.”⁷³

The result of regulatory chill is therefore not a race to the bottom, but the maintenance of the status quo. As Clapp rightly notes:

If the status quo is as stringent as environmental regulations are going to get, then the effect will be an entrenchment of poor quality regulations, and the entrenchment of differences in the stringency of those regulations between rich and poor countries.⁷⁴

This entrenchment has alternatively been referred to as the ‘stuck at the bottom’ effect,⁷⁵ or the ‘stuck in the mud’ phenomenon.⁷⁶ Even Vogel, who has argued that economic integration can lead to ‘trading up’ in environmental and labour standards,⁷⁷ makes the important qualification about races to the top or bottom that “[e]ven if a race exists, not all countries may be contestants.”⁷⁸ Hence, some countries may sprint to the top or bottom while other countries make no, or hardly any, headway in either direction.

Empirically, the regulatory chill hypothesis is very difficult to prove because as Mabey and McNally cogently remark, “evidence is needed of *what has not*

⁷²*Ibid.*, at 136.

⁷³Neumayer 2001a, at 20-21.

⁷⁴Clapp 2002, at 17.

⁷⁵Porter 1999, at 134

⁷⁶Zarsky 1997.

⁷⁷Vogel 1995.

⁷⁸Vogel and Kagan 2004, at 17.

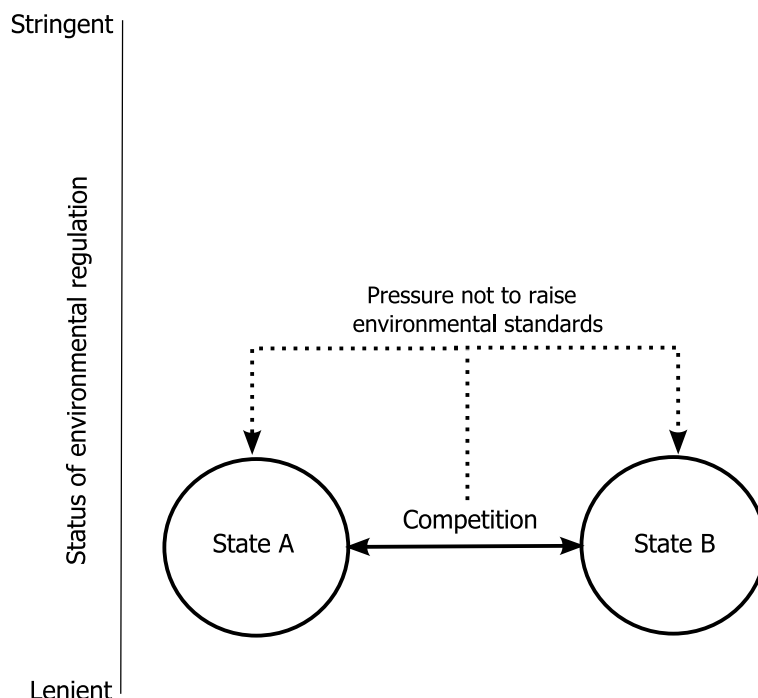


Figure 1.2: Stuck at the Bottom

*happened.”*⁷⁹

1.2.2 The Voice Option

Hirschman suggests that the power of the consumer is “usually believed to originate in the fact that he can take his business elsewhere and can thus ‘punish’ the firm which does not pay heed to his preferences.” This same notion is reflected in the belief that the power of the foreign investor originates in his ability to take his investment elsewhere. But Hirschman goes on to suggest that “another kind of

⁷⁹Mabey and McNally 1998, at 40, emphasis added.

power resides in the consumer who *cannot* take his business elsewhere and who has therefore the maximum incentive to cajole, threaten, and otherwise induce the firm to pay attention to his needs and tastes.”⁸⁰

Exit is not always a viable option for investors, particularly for those who have large ‘sunk costs’ and therefore cannot pick up and leave a jurisdiction without considerable loss.⁸¹ Furthermore, investors may have several projects in a country (and only be in conflict in respect of one) or may have an interest in future investment opportunities, which would be ruled out by a strategy of exit. For these investors, the strategy of voice may be more attractive. However, as Hirschman notes, voice can be costly; time and money must be spent to achieve change in the firm or organization (in this case the organization being the state).⁸² Voice is also conditioned on the influence and bargaining power of the customer or member, or in this case the investor, that is utilizing it.⁸³ Finally, Hirschman also remarks that the successful employment of voice depends to some extent on the “invention of such institutions and mechanisms as can communicate complaints cheaply and effectively.”⁸⁴

The fact that foreign investors lack formal political representation (i.e. they cannot vote in host states) is sometimes equated with an absence of voice.⁸⁵ However, this argument is based on a much narrower conception of voice than that applied in this study. Here it is suggested that investors faced with a conflict with the host state have several voice options. An investor may, for example: lobby or negotiate directly with the government; delegate resolution of the conflict to a third party; utilize reputation and shame sanctions⁸⁶; enlist the assistance of its home state; and/or *threaten* to exit or to utilize one of the measures listed above.

Within the category of delegation to a third party, the investor may have several choices. Depending on the circumstances, an investor could litigate (i.e. pursue a case in the local courts of the host state or in foreign courts), arbitrate (in in-

⁸⁰Hirschman 1970, at 65-66.

⁸¹Newcombe 2007b, at 439-40; Murphy 2004, at 88.

⁸²Hirschman 1970, at 39.

⁸³*Ibid.*, at 40.

⁸⁴*Ibid.*, at 43, emphasis added.

⁸⁵Newcombe 2007b, at 439.

⁸⁶Ginsburg 2005, at 107.

ternational investment arbitration), or instead seek to resolve the conflict through conciliation or mediation mechanisms. It is the use of, or the threat to use, international investment arbitration that is the focus of this study. There are no claims made about the number of conflicts resolved through the other mechanisms, or the relative merits of the different fora available to investors.

Investment Arbitration and the Threat to Arbitrate

When an investor opts to delegate responsibility for the resolution of a conflict to an arbitral tribunal it is not clear that this is, in every case, an expression of voice in the sense that Hirschman meant (i.e. that the purpose is to *change* an objectionable state of affairs). If the objectionable state of affairs relates to the *higher cost* of operations under a new environmental policy, then seeking compensation through arbitration is consistent with Hirschman's notion of voice. However, if the objectionable state of affairs is the complete destruction of the viability of an investment, then the change that investors would be seeking is a reversal of, or exemption from, the culpable policy. As arbitral tribunals are wary of awarding restitution (see Section 4.2.2), such an outcome is unlikely to occur unless a state opts to settle before (or after) the issuing of an award. In this type of situation, recourse to arbitration will most likely be employed to *facilitate exit* by allowing the investor to recoup sunk costs. In fact, it has been suggested that in most cases arbitration is only employed by investors who *wish to exit* the state's jurisdiction. As Otto and Cordes note, "[r]esort to contested arbitration or litigation is a high risk, high cost option," therefore this option is often "reserved only for the most serious situations where investors had little else to lose."⁸⁷

In cases where the investor is more interested in retaining relations with the state in question than with recouping material losses, negotiation is a more likely strategy, at least at the outset. Wells and Ahmed suggest, in their study on Indonesia, that investors interested in retaining or exploring investment opportunities anywhere in the developing world (i.e. not just in the host state) might favour negotiation over arbitration, while those that viewed their venture into the Third World as a mistake, would "collect what they could and run."⁸⁸ However, while

⁸⁷ Otto and Cordes 2002, at V-16.

⁸⁸ Wells and Ahmed 2007, at 10.

the use of arbitration and the decision to exit are closely connected, investors who do not aim to exit may still adopt an arbitration strategy when they are convinced that negotiation is unlikely to produce an acceptable outcome.⁸⁹

In contrast to arbitration, which is risky and costly for investors, the *threat of arbitration* is cheap, does not lead to exit from the jurisdiction, and is nevertheless a potentially potent use of voice. Otto and Cordes suggest that arbitration may be used as “an offensive weapon to harass or intimidate,”⁹⁰ and Peterson notes that “practicing lawyers do admit that they hear rumours of investors applying informal pressure upon host states while brandishing an investment treaty as a potential legal stick.”⁹¹ Even Wälde, a strong advocate of investment arbitration and sometime arbitrator, has noted that due to the high risks of litigation (for investors), “[t]he impact of the arbitration clause is ... less in its actual use, as in its implicit threat to both parties.”⁹² Significantly, unlike an arbitral award which will generally only require a state to compensate an investor, a threat of arbitration can lead to the reversal of environmental policies or regulatory chill.

Regulatory Chill

As noted above, the regulatory chill hypothesis suggests that states fear raising standards because it may deter new investment or result in industrial flight. Hence, the hypothesis is based on the *implicit* threat of exit (or non-entry), and possibly also encompasses the *explicit* threat of exit.⁹³ This traditional notion of regulatory chill can be extended even further to include the fear that states have of breaching commitments in state contracts and IIAs.⁹⁴ This fear may be based on a concern about the direct cost of arbitration, and/or the potentially negative impact that

⁸⁹*Ibid.*, at 270.

⁹⁰Otto and Cordes 2002, at V-34.

⁹¹Peterson 2004, at 139

⁹²Wälde 1998a.

⁹³Hirschman 1970, at 82, notes that “[t]he chances for voice to function effectively as a recuperation mechanism are appreciably strengthened if voice is backed up by the threat of exit, whether it is made openly or whether the possibility of exit is merely well understood to be an element in the situation by all concerned.”

⁹⁴UNCTAD 2005c, at 43; Cosbey *et al.* 2004; Gray 2002, at 311; Mann 2001, at 34; Neumayer 2001a, at 87.

resort to arbitration will have on the country's reputation, particularly amongst prospective investors. As with the threat of exit, the threat of arbitration may be implicit or explicit.

Some observers question the logic of applying the regulatory chill hypothesis to investment arbitration. Coe and Rubins, for example, point out that the hypothesis makes assumptions about the level of awareness that regulators have on issues of international law, which they suggest is likely to be limited.⁹⁵ The argument is that if regulators are not aware of the ramifications of their actions, it will not be possible for their behaviour to be affected. While Coe and Rubins are correct in assuming that many environmental regulators would be unaware of the commitments made in IIAs and state contracts (as these agreements are generally negotiated by separate ministries), this argument ignores the fact that regulators can be *made aware* of the relevant points of international investment law by investors and their lawyers when it is in their interests to do so. In fact, *a lack of knowledge* about the specificities of investment law makes the threat of arbitration all the more potent, because regulators will be less likely to recognize when an investor is bluffing.

Another aspect of the regulatory chill hypothesis that Coe and Rubins critique is the notion that concerns about compensation will prevent states from producing or enforcing regulation:

While the apprehension of international liability may prompt reflection and careful tailoring of means to ends, it seems less likely to cause abandonment of legislation at the heart of a government's mandate. Indeed, to the extent a government *has the machinery to defend such claims*, it might well expect victory, since expropriation claims often fail.⁹⁶

This statement seems to have been written with developed countries in mind; these countries would have little difficulty in making compensation payments, and certainly possess the 'machinery' to defend claims. However, it is a different story for developing countries. Although threats of investment arbitration have occurred in developed states⁹⁷ such threats are likely to be a much greater problem in developing countries where there is less willingness to devote scarce resources to engage

⁹⁵Coe and Rubins 2005, at 599.

⁹⁶*Ibid.*, emphasis added.

⁹⁷E.g., Schneiderman 2001, at 524, claims that the Government of Canada has received threats to

in arbitration.⁹⁸ Furthermore, the statement that a government “might well expect victory” assumes an awareness of the international jurisprudence, which is in contradiction to the earlier statement that regulators will most likely be unaware of the nuances of international law. This statement also fails to acknowledge that the jurisprudence in the area is small and inconsistent, and this creates uncertainty rather than the confidence implied by the authors (see further Chapters 4 and 5).

As with the traditional notion of regulatory chill, empirical evidence of this particular variant of the hypothesis is difficult to collect. In this study, a significant amount of attention is given to investor threats to arbitrate. While the cases that are analyzed neither definitively prove nor disprove the regulatory chill hypothesis, they do contribute significantly to this emerging area of inquiry.

1.3 Research Question and Methodology

Environmental governance can be defined as “the resolution of environmental conflicts through the establishment, reaffirmation or change of institutional arrangements, which may either facilitate or limit the use of environmental resources.”⁹⁹ Significant developments in global environmental governance have occurred in recent years, but binding rules on corporate conduct have not yet emerged (see Section 2.2). Host states, with varying capacities in monitoring and enforcement, are therefore responsible for regulating foreign investment to ensure that sustainable development goals are met and the environment is protected. However, when domestic regulation negatively impacts an investment, conflicts between a foreign investor and the host state may emerge. When investors threaten to initiate arbitration proceedings to resolve these conflicts, governments may respond by rolling back or failing to enforce regulation. When arbitration is initiated, tribunals may decide that host states must compensate investors for regulatory actions, which in turn can have long-term implications for environmental governance. Hence, while there is the potential for IIAs and state contracts to contribute to sustainable

arbitrate from investors in relation to a public auto insurance plan, proposals on cigarette packaging, and the cancellation of plans to privatize an airport. See also Section 5.1.1.

⁹⁸Romano 2002, at 552.

⁹⁹Adger *et al.*, qtd. in Paterson *et al.* 2003, at 3.

development, by promoting FDI flows to developing countries, there is also the possibility that, in reducing domestic policy space or instigating regulatory chill, IIAs will hinder progress to a more sustainable world.

Against this backdrop, the overarching question to be addressed in this study is:

What implications does the protection of foreign investment through international investment agreements and state contracts have for environmental governance, particularly in developing countries?

This research question is clearly closely related to broader discussions about neoliberal globalization and state sovereignty. Sørensen provides a distinction between three central standpoints on the role of the state in the context of globalization: the ‘retreat of the state’ view; the ‘state-centric’ view and the ‘transformationalist’ view.¹⁰⁰

Those identifying a retreat of the state see the changes taking place within the global system as a threat to the power and authority of the state.¹⁰¹ It is argued that, in order to compete for investment and trade in an increasingly open and integrated global economic system, governments pursue policies that favour corporate interests rather than social welfare. Furthermore, it is suggested that globalization has led to an increase in the authority and power of international institutions, an erosion of the distinction between the domestic and international spheres, and the emergence of a transnational civil society; all of which, in the view of retreatists, indicate a decline in state power.¹⁰² Retreatists can come from both ends of the ideological spectrum; while neoliberals view globalization as normatively good and the emergence of a scaled-back state as a positive development, Marxists express grave concerns over the loss of state authority. What these scholars share is a depiction of a triumph of global markets and institutions over the state.¹⁰³

Those identifying with a state-centric view are highly skeptical of these arguments. These scholars have mainly relied on quantitative data to show that the reach of globalization is far more limited than retreatists would suggest. Some

¹⁰⁰Sørensen 2004; 2006.

¹⁰¹See, e.g., Strange 1996.

¹⁰²Weiss 2003a, at 8.

¹⁰³Phillips 2005, at 92.

even suggest that globalization is a ‘myth’ and that states are actually guarding and building up power and authority in many policy areas, particularly in areas of ‘high politics’ such as security.¹⁰⁴

Scholarship in both of these schools has been subject to criticism. Weiss argues that the retreat school holds a negative-sum conception of power that is inappropriate in modern times.¹⁰⁵ Similarly, Phillips argues that:

... a focus on the putative decline of states is premised on a misplaced concern with the *degree* of state intervention rather than the *type* of intervention and the *nature* of the active strategies pursued by states. The appropriate question is not *how much* ‘stateness’ exists but rather *what sorts* of stateness emerge as a result of the variegated impact of globalization.¹⁰⁶

As for the state-centrics, Weiss argues that their focus on proving that globalization is limited or non-existent only serves to endorse the “win-lose premise that ‘more globalisation must equal less scope for state capacity’.”¹⁰⁷

The transformationalist school, which arguably is where most scholars would now situate themselves, finds a middle-ground between state-retreat and state-centric perspectives, and is perhaps most succinctly captured by Cerny’s statement that “[t]he nation-state, of course, is not dead, but its role has changed.”¹⁰⁸ Scholars identifying with this view suggest that in some areas states are losing authority while in other areas they retain, or are increasing, their authority. Transformationalists acknowledge the continuing importance of the state, but also recognize that it has changed and continues to change as an institution, and that new actors and institutions have emerged that challenge the dominance of the state in the global political system.¹⁰⁹

There are a wide range of theoretical approaches adopted by scholars taking a transformationalist view of globalization. This study draws heavily on the work of neo-Gramscians (see Chapter 3). While neo-Gramscians share with Marxists

¹⁰⁴See, e.g., Rugman 2001.

¹⁰⁵Weiss 2003a, at 10.

¹⁰⁶Phillips 2005, at 85, emphasis added.

¹⁰⁷Weiss 2003a, at 14.

¹⁰⁸Cerny 1997, at 251.

¹⁰⁹Lipschutz and Fogel 2002, at 118.

a concern about the increasing power of corporations and global economic institutions, they do not view states as in retreat. Rather, states are required to do *more* in certain areas (such as investment protection) and potentially *less* in others. Furthermore, they view the impacts of globalization as uneven and recognize the potential for structural change.

While the transformationalist view is adopted by a broad range of scholars, the literature remains remarkably limited to examinations of the effects of globalization on a small group of advanced industrialized states.¹¹⁰ Even neo-Gramscian studies of globalization often remain at the macro level or focus on Europe and North America. While, in this study, macro level theory is helpful in the critical assessment of the overarching *institution of investment protection* (see Section 3.2), other mid-level theories and empirical research are required to show the connections between this institution and political outcomes. This is particularly the case given the special focus on developing countries.

1.3.1 A Focus on Developing Countries

As noted above, the vast majority of studies on the impacts of globalization on the state focus on developed countries. Similarly, the bulk of research on the relationship between investment protection and environmental protection addresses investor-state disputes arising under the North American Free Trade Agreement (NAFTA) (see section 2.1.3), and much of the concern in both governmental and non-governmental circles has been on the implications of this agreement for Canada and the US. This is understandable, in some respects, because most of the investor-state disputes relating to the environment have been brought under the NAFTA and because there is far more information available about these cases as a result of a greater degree of transparency in NAFTA arbitrations (see Section 7.1). However, there is an increasing number of disputes in developing countries which have not been extensively researched, and there are quite a number of instances of threats of arbitration in these countries that have been completely neglected in the academic literature. This clear gap in research alone would be sufficient justification for a special focus on developing countries in this study. However, there are

¹¹⁰Sørensen 2004: 172.

several further arguments worth mentioning.

To begin with, the vast majority of IIAs are signed by countries in the Global South, and yet these countries are often poorly prepared to negotiate international agreements.¹¹¹ However difficult it is for developing countries to negotiate fair deals in the multilateral sphere, it is arguably even harder for them to negotiate fair deals on a bilateral basis.¹¹² Jose E. Alvarez, a former member of the American State Department BIT negotiating team and now a Columbia University law professor, claims that for many countries “a BIT relationship is hardly a voluntary, uncoerced transaction” and that “to date the American model BIT has been regarded as, generally-speaking, a take it or leave it proposition, with the United States calling the shots and the BIT partner as supplicant.”¹¹³

In addition to signing more agreements, developing countries are often the only parties with real obligations under IIAs. In theory, inter-state investment agreements are reciprocal in that they require each state party to protect the investors of each other state party when they are operating within their territory. However, this theoretical reciprocity is not sustained in practice. This is because in the majority of investment agreements, state parties are asymmetrically related in terms of investment flows; that is, one state in the relationship exports capital, while the other(s) import capital. This is the case whether the agreement is between a developed country and one or more developing countries or economies in transition, as is the case in that majority of agreements, or if it is between two or more transition/developing economies. Instances of agreements between capital-exporting states are rare, and developed countries are not frequently exposed to investor claims.¹¹⁴ Given the broad range of variation in economic power amongst developing economies, it is not surprising that there is also inequality in so-called ‘South-South’ agreements.¹¹⁵

The asymmetry between states is reflected in an evaluation of the claimants and respondents in the investment arbitration cases initiated to date. As of 2005,

¹¹¹For example, Gupta 2007 discusses the challenges that developing countries face in the negotiations in the climate change regime.

¹¹²Gupta 2006.

¹¹³Qtd. in Garcia 2004, at 316.

¹¹⁴Van Harten 2007a, at 40.

¹¹⁵Bubb and Rose-Ackerman 2007, at 300; UNCTAD 2007b, at 1.

there were only 11 known instances where developing nation firms had filed investment treaty claims.¹¹⁶ Of the 27 claims filed under Chapter 11 of the NAFTA as of the start of 2007, none had been filed by an investor from NAFTA's one developing country member, Mexico.¹¹⁷ As of early 2007, 74% of the concluded and pending cases filed under one set of arbitral rules were against 'middle-income developing countries,' and another 19% against 'low-income developing countries.'¹¹⁸ A mere 1.4% of cases had been filed against G-8 countries.¹¹⁹ Van Harten suggests that middle-income states are particularly susceptible to claims because they are big enough to host substantial investments but not powerful enough to refuse to conclude investment treaties in the first place.¹²⁰ However, it is important also to consider that low-income countries may have faced many threats of arbitration that are not captured by these statistics because the governments chose to settle, rather than risk losing an arbitration. In any event, it is clear that developing countries face the vast majority of claims. The United Nations Conference on Trade and Development (UNCTAD) predicts that in the near future the number of disputes will continue to rise and that developing countries "are likely to bear the brunt" of this increase.¹²¹

The system of international investment arbitration may also be structured in such a way that developing countries are more likely to be penalized.¹²² It has often been argued that weak states will support legalism over power politics, but as Hurrell suggests: "[w]hile it is certainly true that the international legal order provides many power-leveling possibilities for weaker states, it is also true that power influences the character of that legal order."¹²³ Additionally, capacity is recognized as a central factor in the implementation of international commitments.¹²⁴ Kahler argues that "[d]eveloping countries often lack highly developed

¹¹⁶See UNCTAD 2005b, at 4.

¹¹⁷Chung 2007, at 956.

¹¹⁸Anderson and Grusky 2007, at ix.

¹¹⁹All of which were filed against the US under the NAFTA. Cases against Canada under the NAFTA have been filed in another set of arbitral rules.

¹²⁰Van Harten 2007a, at 33-4.

¹²¹UNCTAD 2005b, at 9.

¹²²For an extensive discussion of this issue see Shalakany 2006.

¹²³Hurrell 2005, at 41.

¹²⁴VanDeveer 2005, at 95.

legal systems and the resources that accrue to such systems,” which in turn affects their approach to legalized systems of dispute settlement such as investment arbitration.¹²⁵

Finally, because of economic and political factors, the experiences of developing countries in dealing with investment protection will be very different from those of their more developed counterparts. Phillips argues that:

The implications of globalization look very different in regions such as sub-Saharan Africa, the Caribbean, or Eastern and Central Europe, among many others, where foreign capital occupies a very different place in economic development processes, issues of credibility and competitiveness present much greater challenges, and other constraining conditions are put in place by the much greater prominence of multilateral agents such as the IMF and World Bank.¹²⁶

Developing countries are more desperate to attract FDI and are dependent on aid and trade relationships with the home states of investors. These factors influence how developing countries will perceive their options when faced with a conflict with a foreign investor.

In sum, developing countries have more commitments to protect investors, they have different perceptions about the world order based on economic and political realities, and they have different capacities to deal with investment arbitration. As such, it is not possible to simply transfer the experiences of developed countries, or the theories which develop out of those experiences, to the context of the developing world. Neither is it acceptable to ignore the particular experiences of these countries. If any further justification were needed, this special focus is also warranted by the importance of protecting the environment in developing countries and the significant role that FDI could potentially play in sustainable development.

1.3.2 A Focus on Investor-State Conflicts

The empirical part of this study is concerned with the role that international arbitration plays in the outcome of conflicts between investors and states that are

¹²⁵Kahler 2000, at 666.

¹²⁶Phillips 2005, at 107-8.

related to the environment. This issue is addressed through a number of case studies. The aim of the case studies is to assess how a conflict is interpreted by members of the community (investors, states, tribunal members, NGOs, etc.) as well as the communicative action that the conflict gives rise to, such as reproaches, excuses, justifications, etc.¹²⁷

Identifying when a conflict between an investor and a state is related to the environment is a complicated matter. If one were to define conflict at a normative level, one would require precise definitions of the norms relevant to investment protection and to environmental protection in order to identify when these norms are in conflict. However, the norms of both investment protection and of environmental protection are notoriously vague and require case-by-case interpretation (see Chapter 4). As such, defining a conflict as environmentally relevant on a normative basis is problematic.

To simplify matters, in this study a definition is adopted which establishes that a conflict between an investor and a state pertains to the environment when one or both of the actors subject to the conflict *individually or collectively identifies it as relating to both an environmental issue and to a state contract or an IIA*. To be clear, this definition does not require that both parties *agree* that the conflict is related to an environmental issue or to a state contract/IIA. For instance a government could argue that a measure was introduced for the purpose of protecting the environment, whereas an investor might conversely claim that the government was only using environmental concern as a cover for protectionism. At the same time, a government might argue that a state contract or an IIA is not applicable to the investment in question, while the investor maintains that it is. The arguments of investors and governments will be considered in the analysis of the conflicts studied, but it simplifies matters to keep the definition rather broad at the outset.

It should also be emphasized that the focus in this study is on the *outcome* of conflicts between investors and states. The *impact* of these conflicts is a different matter. It is beyond the scope of this study to assess the long term effect of a given outcome on the development of environmental policy, particularly given that the cases discussed have either been resolved very recently, or are in fact still pending resolution. Moreover, there are no claims as to the actual impact on the

¹²⁷ Hasenclever *et al.* 1997, at 16; Kratochwil and Ruggie 1986, at 768.

environment itself. It is a basic assumption made in this study that the progressive development of environmental policy is necessary to achieve environmental protection; however, it cannot be assumed that, in the absence of a conflict, a given policy would have resulted in the attainment of a specific environmental goal.

First-Order and Second-Order Cases

Further differentiation is made in this study between conflicts that are resolved *directly* through international arbitration and those resolved *in the shadow* of international arbitration.

A conflict that enters into an arbitration process is typically referred to in the literature as an *investor-state dispute*. The outcome of an investor-state dispute is generally an arbitral award. However, it is also possible for the parties to a dispute to choose to settle before (or even after) an award has been issued. Instead of separating negotiated outcomes from arbitrated outcomes, the outcome of investor-state disputes proper are termed *first-order*. These outcomes *directly involve the decisions of arbitral tribunals*.

In first-order cases, the main methodology is content analysis of the legal materials of the arbitration proceedings (e.g., notices of arbitration, statements of claim and defence, and tribunal decisions and awards) combined with a survey of the literature, and supplemented by ‘grey’ material (newspaper articles, reports and websites of governments, international organizations, and NGOs, etc.). The choice of first-order cases was based on the following criteria:

- the conflict pertained to the environment (see explanation above);
- arbitral awards were made on the jurisdiction, and possibly on the merits of the case; and
- arbitral awards were made publicly available.

Second-order cases are those where an investor *publicly invoked a claim of a breach of an investment agreement or contract* or where a government *made public that it had been threatened with arbitration*, but that were not resolved through

arbitration.¹²⁸ The threat must be publicized for the simple reason that, otherwise, it would not be knowable at the stage of case selection. For this reason, no arguments are made about the number or frequency of cases in which investors make such a threat but subsequently resolve the conflict outside of arbitration; it is quite likely that there are far more than are assessed in this study. Furthermore, nothing can be stated about the importance of a purely *implicit* threat of arbitration. It is also acknowledged that by choosing only publicly-known cases, the study is potentially biased toward an examination of conflicts involving large TNCs which, in general, receive more attention from the press. It should also be noted that only those cases for which a reasonable amount of information, in English, could be collected (i.e. more than one or two reports identifying a conflict) were chosen.

While the first-order cases only relate to conflicts over *policy*, two of the second-order cases relate to conflicts over *domestic court proceedings*. Although, in the latter category, it is the actions of domestic courts rather than governments that are the source of conflict, it should be emphasized that only the national government can be held liable under IIAs and state contracts. Finally, it should be noted that an exclusive focus was given to second-order cases in developing countries. In summary, the criteria for the selection of the second-order cases were:

- the conflict was between a foreign investor and a developing country government;
- the conflict pertained to the environment;
- no tribunal decision was made on the jurisdiction or the merits of the case; and
- sufficient information on the case was publicly available.

Second-order cases can be further divided into field-cases and desk-cases. In the two field-cases, in Indonesia and Ghana, a survey of the literature and grey material is complemented by stakeholder interviews. These interviews were conducted in May/June (Ghana) and July/August (Indonesia) of 2005. Interviewees

¹²⁸The majority of the cases assessed were resolved through negotiation, though in one case the matter was resolved in a foreign court.

in the government, academic, non-governmental, and private sectors were contacted using the ‘snowball’ method.¹²⁹ First, relevant individuals were identified based on the survey of the literature and grey material. Second, each interviewee was asked to suggest further relevant individuals for interview. The interviews were semi-structured; questions were open-ended to encourage discussion and to avoid leading the interviewee.¹³⁰ The average interview lasted one hour, and was conducted upon the condition of anonymity. All interviews referred to in the text, therefore, are accredited only to the ‘type’ of interviewee, with reference to the date and location of the interview. Desk-cases are structured in the same manner as field-cases, but they rely only on literature and grey material, not interviews.

In order to minimize bias in the second-order cases, multiple sources are drawn upon and information is triangulated.¹³¹ Furthermore, in an attempt to differentiate between the influence of the threat of arbitration and “background noise of general political developments, ranging from the activities of other actors to more generic factors that influence behavioural changes, such as economic changes, elections, or some form of crisis,”¹³² counterfactual analysis is employed.

1.4 Summary and Overview

This chapter has introduced the complex relationship that exists between foreign investment and sustainable development. It has been suggested that as environmental regulation becomes more stringent, and thereby more costly for investors, conflicts between investors and host states are likely to emerge. When a conflict develops an investor may choose to exit the state’s jurisdiction. The issue of industrial flight and the associated pollution havens hypothesis have been extensively studied in the literature. However, an investor may alternatively choose to exercise voice, that is to attempt to change rather than escape from the objectionable state of affairs that has arisen. In such cases, arbitration, or the threat of arbitra-

¹²⁹Minichiello *et al.* 1990.

¹³⁰Yin 2003, at 90.

¹³¹*Ibid.*, at 97.

¹³²Biermann and Bauer 2004, at 191.

tion, may be employed. One potential implication is that governments that fear a costly arbitration will rollback or fail to develop and implement environmental policy (regulatory chill). This study aims to assess this hypothesis, as well as to explore other possible implications of investment protection for environmental governance.

The next chapter provides a more detailed description of the *historical context* in which this study is situated. It covers the evolution of both the international efforts to provide protection for foreign investors and those aimed at environmental protection over the last century.

Chapter 3 sets out the theoretical framework employed in this study. The chapter outlines a variety of conventional and unconventional approaches in international relations scholarship and explains why a critical approach that draws primarily on neo-Gramscian theory was chosen to guide the research. A key concept - the *institution of investment protection* - is defined in Chapter 3, and neo-Gramscian theory is applied in a critical assessment of this institution.

In Chapter 4, the *key norms and rules* of investment protection that are relevant to the protection of the environment are discussed and analyzed. The chapter first explores in detail the key regulative rules covering national treatment, most-favoured-nation treatment, the international minimum standard/fair and equitable treatment, expropriation, performance requirements, stability of host country law, and observance of obligations (umbrella clauses). It then examines the procedural norms and rules of investment arbitration, including the selection of arbitrators, conduct of proceedings, and the production, annulment, and review of awards.

Chapter 5 delves into the complexities of actual cases that have been resolved in investment arbitration (*first-order outcomes*). The disputes that are reviewed cover a wide range of regulatory actions and several different environmental issues (e.g., hazardous waste, biodiversity, air/water pollution). Cases from developed countries (Canada and the US) are discussed, as are cases from the developing world (Peru, Costa Rica, and Mexico).

Chapter 6 provides a detailed examination of investor-state conflicts that were resolved without recourse to arbitration, but where the existence of investment protection nevertheless played an important role (*second-order outcomes*). Conflicts between investors and host states over both environmental regulation (in Ghana, Indonesia, and Costa Rica) and domestic court proceedings on environ-

mental matters (in Indonesia and Ecuador) are examined.

Chapter 7 addresses *new developments* in the field of investment law and arbitration practice. The substantial increase in the use of investment arbitration has led to greater scrutiny of the regulative and procedural norms and rules of investment protection and, in some cases, to a re-evaluation of the purpose and function of these norms and rules. States, arbitral supervisory bodies, arbitrators, and NGOs have all played a role in bringing about change. This chapter reviews these new developments as well as several proposals for further reform.

Chapter 8 provides the main conclusions of the study as well as policy recommendations, reflections on neo-Gramscian theory, and suggestions for areas in need of further research.

Historical Context

2

This chapter concisely traces the history of the efforts to date at the international level both to protect foreign investors and to regulate foreign investment with a view to the protection of the environment. The histories are divided into three periods: the colonial period (pre-1945), the post-colonial period (1945-1980), and the modern period (1980-present).

2.1 A Brief History of Foreign Investment Protection

2.1.1 The Colonial Period: Pre-1945

With the exception of the Dutch, who directly invested in various commercial projects throughout Europe as early as the 17th century, prior to the 1800s most countries were deterred from participating in FDI by the limitations of travel and communication.¹ The Industrial Revolution changed all of this. Significant capital surpluses were produced which fueled demand for the development of large manufacturing and transportation enterprises, thus requiring and facilitating more investment. However, the majority of this early investment was portfolio and not

¹Vandeveldt 1998b, at 376.

direct investment, and was confined mainly within Europe and North America.² This changed in the colonial period when the colonies became a major source of the raw materials required to propel Western industrialization.

In the colonial period there was little need for the development of an international law for the protection of foreign investment, as in many developing countries the colonial legal systems were integrated into those of the imperial powers, and in areas that remained uncolonized the use of ‘gun-boat diplomacy’ was considered an acceptable means of protecting foreign interests abroad.³ However, that is not to say that no concepts of appropriate treatment of foreign investors had emerged prior to decolonization. The first Friendship Commerce and Navigation (FCN) Treaty⁴ (a precursor to modern IIAs) was signed between the US and France in 1778.⁵ Several attempts to formulate a broader investment protection regime were also made in the first half of the 20th century.⁶ Furthermore, there were several critical developments which occurred in the specific context of relations between the US and several Latin American countries which had already gained independence.

The Calvo Doctrine and the Hull Formula

Historically, the direct taking of foreign property was one of the most significant risks to foreign investment and usually came in the form of what is termed ‘nation-

²*Ibid.*, at 376-7.

³Sornarajah 2004a, at 19-20; Lipson 1985, at 12.

⁴The American FCN treaties were primarily aimed at promoting trade, but often included investor protections such as prohibitions on expropriation without compensation. The FCN program wound down in the 1960s with the emergence of the General Agreement on Tariffs and Trade (GATT). See further Guzman 1998, at 653.

⁵Mosoti 2005, at 108.

⁶Muchlinski 1999, notes the following examples: in 1929, the League of Nations held a conference with the aim of developing an international convention on the treatment of foreigners and foreign enterprises; in 1930, the Hague Conference on the Codification of International Law covered the topic of state responsibility for damages caused to foreigners and their property; and in 1931 the International Chamber of Commerce (ICC) launched a campaign to develop a convention on the topic, and followed up with a draft code for the Fair Treatment of Foreign Investments in 1949. All of these initiatives failed as a result of a lack of consensus among states. See also Van Harten 2007a, ch. 2.

alization'. Nationalization involves the host government performing an outright taking of property in all economic sectors or on an industry-specific basis. In contrast to nationalization, 'expropriation' involves takings targeted at specific properties and enterprises. Capital-exporting states have long supported the notion that there is a requirement under customary international law that a state compensate a foreign investor whose property is expropriated or nationalized. They have further argued that there is an international minimum standard of treatment that should be applied to aliens even when the treatment of nationals falls below this standard.

One of the first major nationalizations in the 20th century occurred in the Soviet Union following the Communist Revolution. Contrary to the Western view, the Bolshevik government took the position that international law can impose no requirement on the host state to compensate a foreign investor for expropriation and that only the national law of the host state is relevant.⁷

However, it was not only socialism which challenged the dominant view on the international minimum standard and compensation for expropriation.⁸ Economic nationalism was the ideological underpinning of one of the most famous dissents from these norms, formulated by Carlos Calvo, a distinguished jurist from Argentina, who declared in 1896 that, "[t]he responsibility of Governments towards foreigners cannot be greater than that which these Governments have towards their own citizens."⁹ The Calvo doctrine thus rejected the notion that special international law norms apply to the treatment of foreign nationals by a host state. It furthermore rejected the right of home states to exercise diplomatic protection of their nationals abroad, and challenged the very basis of international tribunals.¹⁰

Calvo clauses appeared in a number of constitutions in newly independent Latin American states. Lipson points out that the Mexican Constitution (1917), for example, "contained strict, and unprecedented, restraints on foreign corporations ... guaranteed free land to every landless peasant and allowed the government to carry out expropriation at any time for the nation's welfare."¹¹ It was not until 1938 that the provisions of the Constitution were applied in practice when

⁷Vandeveld 1998b, at 380-1.

⁸Muchlinski 2001, at 117; 1999, at 48-9.

⁹Qtd. in Center for International Environmental Law (CIEL) 2003b, at 1.

¹⁰Vandeveld 1998, at 380; Lipson 1985, at 18-9.

¹¹Lipson 1985, at 18-9.

the Mexican government announced that it would expropriate the property of several American and British oil companies operating in Mexico (as well as several agrarian properties). Both the US and the United Kingdom (UK) protested this action, and the British went so far as to suspend diplomatic relations with Mexico. The Americans recognized the right of the Mexican government to expropriate property within its territory, but demanded that the companies be compensated for their lost investment. A famous exchange of notes occurred between the American Secretary of State Cordell Hull and his Mexican counterpart, the Minister of Foreign Affairs Eduardo Hay, and the Mexican Ambassador in Washington. These notes were illustrative of the divide between the two countries, and more broadly between capital-exporting and capital-importing states, on the issue of appropriate treatment of foreign investors. In a note of 3 April 1940 to the Mexican Ambassador in Washington, Hull articulated what would become known as the Hull formula for compensation:

The Government of the US readily recognizes the right of a sovereign state to expropriate property for public purposes. This view has been stated in a number of communications addressed to your government during the past two years ... On each occasion, however, it has been stated with equal emphasis that the right to expropriate property is coupled with and conditioned on the obligation to make *adequate, effective, and prompt compensation*. The legality of an expropriation is in fact dependent upon the observation of this requirement.¹²

In summary, by the end of the colonial period there were three main views expressed by states concerning the protection of foreign investors. Firstly, capital-exporting states (whether following a liberal or economic nationalist policy) supported the notion of an international minimum standard of treatment, and the requirement for prompt, adequate, and effective compensation (Hull formula). Secondly, socialist states, following Marxism, rejected the entire notion that international law protected foreign investment. Thirdly, the ‘Calvo states’ (developing countries not under colonial rule, largely Latin American, and following economic nationalism) argued that foreign investors were only entitled to the same treatment as nationals.¹³ These three views would spread throughout the rest of the world

¹² Qtd. in Einhorn 1974, at 21, emphasis added.

¹³ Vandevelde 1998, at 381.

following the dissolution of the colonial empires.

2.1.2 The Post-Colonial Period: 1945-1980

A decade of expropriation in the newly socialist countries of Eastern Europe and China followed the end of World War II, while as Vagts points out, “[i]n the meantime, the rest of the world remained fairly quiet.”¹⁴ The focus would shift to developing countries from 1950 onward as improvements in communication and transportation facilitated FDI flows around the world. While notable expropriations were occurring in Guatemala, Iran, Algeria, and Cuba, many economic nationalist developing states actively sought FDI in this period under a strategy known as import substitution industrialization, whereby they aimed to develop industries to manufacture goods to displace imports.¹⁵

While in the 1950s many developing countries encouraged investment and enacted investment codes, by the late 1960s many countries had become, as Akinsanya puts it, “more circumspect” about the value of FDI for development, leading to further expropriations.¹⁶ The mean number of expropriations annually peaked at 51 in the early 1970s.¹⁷ Gun-boat diplomacy was no longer a viable option for capital-exporting states to protect property abroad. The focus then turned to alternatives, mainly in the form of economic sanctions and the development of international law. Developing countries also turned to international law to develop their own position, largely in the UN General Assembly.

The Havana Charter

The Havana Charter, which laid the framework for the International Trade Organization (ITO) (intended to be the ‘third pillar’ of the Bretton Woods system), included a provision on investment.¹⁸ The debates over the provision were heated,

¹⁴Vagts 1987, at 4.

¹⁵Vandevelde 1998b, at 381-2.

¹⁶Akinsanya 1980, at 2.

¹⁷Brewer and Young 1998, at 53.

¹⁸Havana Charter for an International Trade Organization, Final Act and Related Documents of the United Nations Conference on Trade and Employment, 21 November 1947-24 March 1948, Havana, Cuba, UN Doc E/Conf. 2/78, at Art. 12.

and Lipson argues that they “clearly demonstrated the lack of broad international approval for traditional investment laws.”¹⁹ The final formulation of the article allowed host countries significant leeway to determine investment policy, although developing countries continued to view the provision as too lenient with respect to TNCs.²⁰ In any case, the Havana Charter never came into force as it was repeatedly rejected by the US Congress, in part because the investment provisions, and the agreement as a whole, were viewed as a threat to the interests of American corporations.²¹ Muchlinski suggests that:

The inclusion of a right of capital importing states to control the conditions of foreign investment, and the absence of any unequivocal provision for compensation in the case of expropriation, caused widespread opposition to the Havana Charter among business interests and contributed to its demise.²²

The General Agreement on Tariffs and Trade (GATT), which became the *de facto* basis of international trade law, did not cover investment. Brewer and Young argue that the debate over investment in the ITO was significant for drawing the lines of conflict between developed and developing countries over a series of issues and for (temporarily) resolving the issue of whether international cooperation on investment should be sought on a multilateral or bilateral basis, with the US showing a clear preference for the latter.²³

Permanent Sovereignty over Natural Resources

The notion of permanent sovereignty over natural resources first emerged in the 1950s, and has since been “one of the most frequently employed legal precepts in the debate on the relations between host States and transnational companies.”²⁴ The concept was first elucidated in UN Resolution 626 (VII) of 21 December 1952 on the Right to Exploit Freely Natural Wealth and Resources. The US voted against this Resolution because it failed to indicate that states expropriating private

¹⁹Lipson 1985, at 87.

²⁰Dattu 2000, at 288.

²¹Brewer and Young 1998, at 68.

²²Muchlinski 1999, at 53.

²³Brewer and Young 1998, at 68.

²⁴Paasivirta 1989, at 339.

property should recognize rights of foreign investors under international law.²⁵ Nevertheless the Resolution passed and was later invoked by Guatemala when the country expropriated the assets of Compania Agricola de Guatemala (a subsidiary of the United Fruit Company) and also in the court decisions upholding the legality of the Iranian expropriation of the Anglo-Iranian Oil Company.²⁶

From the early 1960s to the mid 1970s, developing countries pushed through a series of resolutions in the UN General Assembly in an effort to universalize the Calvo doctrine and to affirm a position of sovereignty of nations with respect to foreign investment and the exploitation of natural resources.²⁷ This included the 1962 and 1973 Resolutions on Permanent Sovereignty over Natural Resources,²⁸ the 1974 Resolution on a New International Economic Order,²⁹ and the 1974 Resolution on the Charter of Economic Rights and Duties of States (CERDS).³⁰ These Resolutions all focused on the rights of states to regulate investment in the manner that they chose, to nationalize and expropriate foreign property, and to pay ‘appropriate’ compensation to investors.³¹

The Responses of Capital-Exporting States

There was a variety of responses from capital-exporting countries to the sweeping nationalization programs in many developing countries and to the General Assembly Resolutions. In particular, economic sanctions were employed on several occasions to pressure governments to provide compensation to affected companies. Sanctions were made in the areas of finance (e.g., suspension of bilateral foreign aid programs, voting against loan applications in international financial institutions, blocking/freezing of assets) and trade (e.g., denial of preferential treatment).³² However, as Akinsanya points out, the response was not uniform:

²⁵ Akinsanya 1980, at 49.

²⁶ *Ibid.*, at 50.

²⁷ Guzman 1998, at 648.

²⁸ Res. 1803 and 3171.

²⁹ Res. 3201.

³⁰ Res. 3281.

³¹ For a comprehensive discussion of these resolutions see Schrijver 1997.

³² Akinsanya 1980, at 284.

while expropriations of alien-owned investments in the banking, insurance, and agricultural sectors do not generate much acrimony between the host and aliens' home governments, expropriations of mining and petroleum corporations as well as telecommunications corporations generate heated controversies that more often than not bring the aliens' home governments to the rescue of their nationals.³³

Sanctions were particularly important in American policy, and the US was also, of course, the preeminent economy at the time.³⁴ In 1962, the US Congress passed an amendment to the Foreign Assistance Act, known as the Hickenlooper Amendment (named after a Senator from Iowa). The Amendment stipulated that in the event of an expropriation of an American investment, if the host state did not take 'appropriate steps' to compensate the investor within six months, the US President was required to cut off aid to that country.³⁵ In 1963, the Amendment was invoked against Sri Lanka (then Ceylon).³⁶

This strategy was extended in 1965, when an amendment to the Act which authorizes the US government to make contributions to the Inter-American Development Bank Fund for Special Operations required that the US government vote against any loan to a country to which American assistance had been suspended under the Hickenlooper Amendment. The Overseas Investment Corporation (OPIC)³⁷ was also prohibited from insuring contracts in countries that were not in compliance with the Amendment, and similar steps were taken to suspend import quotas under the Sugar Act to any country that made expropriation without compensation.³⁸ Finally, the US also utilized its power within the World Bank to withhold loans. For example, it abstained from voting on a loan to upgrade Guyana's sea defenses, because compensation talks between the government of Guyana and an American mining company whose assets in the country had been

³³ *Ibid.*, at 176.

³⁴ The US accounted for more than half of the world stock of FDI by the late 1960s. See Brewer and Young 1998, at 87.

³⁵ Einhorn 1974, at 23.

³⁶ Brookens 1978, at 51.

³⁷ OPIC is a US government agency that provides financing and political risk insurance for US businesses investing abroad. See <http://www.opic.gov>.

³⁸ Brookens 1978, at 52; Einhorn 1974, at 24.

expropriated had not “proceeded sufficiently.”³⁹ Similar arguments were made when the US failed to support loans to Bolivia, Iraq, and Peru in the early 1970s.⁴⁰

While Lipson argues that the US sanction techniques were remarkably effective throughout the mid-1960s, in the long-run they were not an adequate solution to the problem.⁴¹ Realizing the limitations to economic sanctions, capital-exporting states also sought to improve the protection of foreign investors through international law. In the period when developing countries were collectively arguing for permanent sovereignty over natural resources, they were simultaneously agreeing under bilateral terms to more traditional/Western concepts of foreign investment protection. These bilateral agreements are discussed in Section 2.1.3.

Developed countries also pushed the theory of the ‘internationalization’ of contracts. This theory was centered around two main issues: (i) what law should govern contracts; and (ii) what forum disputes should be settled in. In terms of the first issue - ‘choice of law’ - it was argued by proponents of internationalization that contracts should be governed by ‘general principles of law’⁴² rather than the domestic law of the host state. In terms of the second issue, proponents of internationalization argued that disputes should be convened in international arbitration rather than in local courts. International arbitration, in contrast to domestic judicial systems, is commonly framed in the literature as a neutral and depoliticized forum for dispute resolution.⁴³

Private sector interests in the US, the UK, and West Germany also initiated their own efforts to push for a broad agreement on investment protection. In 1959, investor organizations completed the Abs-Shawcross Draft Convention on Investment Abroad.⁴⁴ The Draft Convention was described as the ‘Magna Carta’ of

³⁹Einhorn 1974, at 86.

⁴⁰Brookens 1978, at 51.

⁴¹Lipson 1985, at 108.

⁴²UNCTAD 2004b, at 6. Also referred to as ‘principles of law recognized by civilized nations’, ‘transnational law of business’, ‘*lex mercatoria*’, or simply ‘international law.’

⁴³See Coe 2005, at 925, who notes that former Secretary General of the International Centre for the Settlement of Disputes (ICSID), Ibrahim Shihata, described the key objective of the organization as being to depoliticize the resolution of investment disputes by providing access to a neutral forum and precluding the involvement of home states. For other examples see: Legum 2006, at 526; Pryles 2005, at 419; Alvarez and Park 2003, at 369.

⁴⁴Reproduced in UNCTAD 2000a, at 301.

private investors, and it introduced the idea of investors *directly* pursuing claims against states in international arbitration.⁴⁵ The Convention was evaluated by the Organisation for European Economic Cooperation (OEEC), now known as the OECD, which led to the OECD Draft Convention on the Protection of Foreign Property of 1962.⁴⁶ While the OECD Draft Convention was never adopted due to opposition from some countries, it was revised in 1967 and approved by the Council of the OECD (with Turkey and Spain abstaining) as a model for bilateral agreements adopted by Member States.⁴⁷ An UNCTAD report remarks that the importance of the OECD Draft Convention “rests mainly in the fact that, at a time when most developing countries - and some developed countries too - were very supportive of national controls over foreign direct investment, it placed emphasis on the protection of foreign investments.”⁴⁸

Finally, capital-exporting countries also made efforts to diminish the standing of the UN General Assembly Resolutions. In this respect the CERDS was the main target. The US Council of the International Chamber of Commerce (ICC) described the Charter as “the cutting edge of a threat to the well-being - and even the existence - of foreign-owned private enterprise and to the security of foreign investment in many countries.”⁴⁹ The CERDS was denied legal authority and status as customary international law by many capital-exporting countries.⁵⁰ While it was supported by a majority of states, it was not endorsed by any of the most important economies, which represent the bulk of outward international investment flows.

2.1.3 The Modern Period: 1980-Present

The modern period marks a paradigm shift in attitudes and policies in developing countries in terms of foreign investment. As Vandavelde remarks, “[n]o single event accounts for the sudden reversal in investment policy and the emergence of

⁴⁵Van Harten 2007a, at 20.

⁴⁶OECD Doc. C(67)102, <http://www.oecd.org>. Reproduced in 7 *ILM* (1968), at 117.

⁴⁷Muchlinski 2001, at 117-8.

⁴⁸UNCTAD 1999a, at 8.

⁴⁹Qtd. in Akinsanya 1980, at 66.

⁵⁰Mosoti 2005, at 112.

the contemporary consensus” on the benefits of FDI.⁵¹ However, many observers suggest that the most significant factor was the debt crisis that erupted in 1982.⁵² As a result of the crisis, developing countries were desperate for foreign capital and were finding financial aid and preferential loans increasingly scarce. Furthermore, their experience suggested that perhaps foreign investors were less likely to interfere in their economies than were international and foreign lending organizations.⁵³ In addition, financial institutions such as the World Bank and International Monetary Fund (IMF) also placed pressure on developing countries to open their doors to investors, as did capital-exporting states.⁵⁴

In the modern period, it can be said that the majority of developing countries have sought to attract greater flows of FDI. At the same time, many developed countries have also endeavored to increase their share of investment flows and capital has become more mobile.⁵⁵ These factors have resulted in competition between states to attract investment.⁵⁶ Governments compete for investment by providing incentives, such as tax holidays, loan guarantees and cash grants, and also by differentiating their legal jurisdictions from those of their competitors.⁵⁷ In this latter sense, legal reform has become an important asset for developing countries.⁵⁸ As Van Harten points out, as states compete for investment “the bar rises as to what qualifies as a hospitable investment climate,”⁵⁹ which Guzman describes as a “bidding up” of concessions to foreign investors.⁶⁰

As a result of the shift in attitude and approach to investment in developing countries, there have been extensive changes in the national laws of host states, both in terms of the development of general investment codes and in terms of the policies adopted in specific sectors. According to the 2005 World Investment

⁵¹ Vandevelde 1998, at 386.

⁵² Van Harten 2007a, at 42; Brooks *et al.* 2004, at 1; Sornarajah 2004b, at 210; Balasubramanyam 1999, at 36; Moran and Pearson 1990, at 29.

⁵³ Vandevelde 1998, at 389.

⁵⁴ Van Harten 2007a, at 42.

⁵⁵ Oman 2000, at 15-16.

⁵⁶ *Ibid.*, and Chudnovsky and López 2002, at 45.

⁵⁷ Encarnation and Wells 1985, at 48.

⁵⁸ Trubek *et al.* 1994, at 477.

⁵⁹ Van Harten 2007a, at 43.

⁶⁰ Guzman 1998, at 671-2.

Report, 2,156 measures related to foreign investment were adopted by 102 developing countries between 1991 and 2004, the vast majority of which (93%) were aimed at creating a more favourable environment for investors.⁶¹ Similarly, around 120 countries reformed their mineral regimes between 1985 and 2002.⁶² These mineral reforms have generally aimed at liberalization as well as at establishing an investment climate based on stability and predictability.⁶³

However, investment protection is limited when it is only enshrined in national laws which can be modified at will. Furthermore, due to the perceived or real corruption of local courts in many countries, investors do not feel that they are a neutral or fair forum for the resolution of disputes.⁶⁴ In this view, therefore, international agreements and access to international arbitration are required to ensure the protection of foreign investors, and thereby to facilitate flows of investment to developing countries. This is the reasoning behind the push in the modern period for the development of IIAs.

Regional Free Trade Agreements

While von Moltke argues that it is “a mistake to view foreign direct investment simply as an adjunct to trade,” there are clear links between trade and investment which some have used as justification for negotiating a multilateral agreement on investment within the World Trade Organization (WTO) (see below).⁶⁵ The inclusion of investment provisions within regional free trade agreements (FTAs) is also becoming increasingly common. The first FTA to contain significant protections for foreign investors, including access to international arbitration, was the NAFTA involving Canada, Mexico, and the US.⁶⁶

⁶¹UNCTAD 2005d, at 26.

⁶²Otto and Cordes 2002, at III-3.

⁶³Bastida 2002.

⁶⁴Peter 1995, at 328.

⁶⁵von Moltke 2002a, at 347.

⁶⁶North American Free Trade Agreement, 17 December 1992, Ottawa, Mexico, Washington. While it is not directly relevant to this study, it is worth briefly mentioning the North American Agreement on Environmental Cooperation (NAAEC), a side agreement to the NAFTA enacted in 1993. The aim of the agreement is to ensure that states effectively enforce their environmental laws and regulations (essentially it is based on concerns about pollution havens - see Section 1.2.1). The Commission

The NAFTA's Chapter 11 on investment marks a significant milestone in investment law, despite the fact that the language of many of the provisions in the agreement is essentially drawn, with relatively minor modifications, from BITs that the US had concluded prior to 1993.⁶⁷ It is nonetheless noteworthy, firstly, because it marks what was and remains a rather rare occurrence - an investment agreement involving more than one developed state. Secondly, investor-state dispute settlement under Chapter 11 has been extensively employed by investors, marking a new era of investment arbitration and arguably triggering the current surge in disputes brought under other agreements.⁶⁸ Despite the fact that the investment chapter was largely aimed at constraining Mexico,⁶⁹ suits have been brought by investors against all three signatory countries. Thirdly, the pleadings in these suits were argued in ways not previously contemplated by governments, and through NAFTA tribunal decisions the substantive content of investor rights has arguably evolved and expanded. The public policy implications of investment agreements first became apparent in NAFTA disputes (see Chapter 5) and the agreement has also become a focal point for debate on the 'right to regulate'.

Since the conclusion of the NAFTA, several similar treaties have been negotiated which expand NAFTA-style investment protection to Central and South America. The Central American Free Trade Agreement (CAFTA) was signed in 2004, by the US, Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua. When the Dominican Republic joined the group later in the year the acronym was modified to CAFTA-DR.⁷⁰ While the CAFTA-DR is viewed as an important agreement, many see it as merely a stepping-stone for the Free Trade Area of the Americas (FTAA), an agreement that would cover North, Central, and South America, and the Caribbean (excluding only Cuba). The agreement was originally proposed at the 1994 Summit of the Americas. The 1998 Declaration of the

on Environmental Cooperation (CEC) was established by the NAAEC to adjudicate environmental claims. Non-enforcement of existing environmental laws can be challenged by the CEC, but laws on the exploitation of natural resources are excluded.

⁶⁷Gantz 2001, at 671.

⁶⁸Weiler 2003, at 67, remarks that the Chapter 11 "acted as the catalyst for an explosion of investment claims."

⁶⁹Brower 2001b, at 51.

⁷⁰Central America-Dominican Republic-United States Free Trade Agreement, 5 August 2004, Washington.

Second Summit of the Americas in San José called on the negotiators to:

establish a fair and transparent legal framework to promote investment through the creation of a stable and predictable environment that protects the investor, his investment and related flows, without creating obstacles to investment from outside the hemisphere.⁷¹

As with the CAFTA-DR, the draft FTAA followed the NAFTA model with some modification. In the most recent publicly available draft of the proposed text it is clear that consensus has not been reached on many investment issues; even the definition of the pivotal and basic concepts of ‘investor’ and ‘investment’ are disputed.⁷²

If successfully concluded, the FTAA would be the most far-reaching trade agreement in history, as well as the most significant IIA. However, the initial deadline of January 2005 for the signing of the agreement was not met, and negotiations have remained deadlocked since February 2004, primarily due to ongoing disagreements between the delegates on farm subsidies and intellectual property rights.⁷³ Public opposition to the Agreement has also been intense.⁷⁴

The Fall of the Multilateral Agreement on Investment

Despite the strong desire amongst most countries in the world to promote and to attract FDI, a truly multilateral agreement on investment has not emerged. However, there have been several attempts to develop such an agreement, the most significant being the negotiation of the Multilateral Agreement on Investment (MAI) in the mid-1990s. It is worthwhile to briefly review the MAI negotiations as they brought environmental issues to the forefront of discussions on investment protection for the first time.

⁷¹Qtd. in Mann and Araya 2002, at 172.

⁷²Third Draft FTAA Agreement, 21 November 2003, <http://www.ftaa-alca.org>.

⁷³“Summit of the Americas Fails to Resurrect FTAA,” *Bridges Weekly Trade News Digest* 9(38), 9 November 2005.

⁷⁴Large protests took place at both the Summit of the Americas held in Quebec City in 2001 in and Miami in 2003. In Brazil a plebiscite organized by NGOs resulted in over 10 million votes cast against the agreement.

The MAI negotiations took place within the OECD commencing in 1995. The OECD was viewed by the US government as a ‘friendly forum’ where a ‘high standards’-regime could be negotiated, which could subsequently be opened for ratification by non-OECD states.⁷⁵ Despite the advantages of a friendly forum, European governments and business lobbies were not convinced that the OECD was an appropriate locus for discussions and continued to favour the WTO instead.⁷⁶ However, given the opposition of developing countries to opening negotiations in the WTO, the American position eventually prevailed. Five non-OECD countries (Argentina, Brazil, Chile, Hong Kong, and the Slovak Republic) were granted observer status in the negotiations. The initial deadline for an agreement to be reached was 1997, which was subsequently pushed back to 1998. Negotiations were effectively abandoned in October of 1998 when France withdrew its delegation.

Various factors contributed to the breakdown of the MAI negotiations. According to an article in *The Economist*, the problems began with the choice of the OECD as the forum.⁷⁷ The OECD has a membership of only 30 countries. OECD countries act both as the primary source and as the main destination for FDI, but it was widely acknowledged that an agreement on investment between only these countries would be largely irrelevant, given that they already have strong domestic protections for foreign investors. The strategy of drafting an agreement among countries where it was relatively unnecessary and later expanding it to the rest of the world was problematic given the likely reluctance of non-OECD countries to sign an agreement that they had not been involved in drafting.⁷⁸ However, opponents of the MAI argued that developing countries would feel compelled to ratify the agreement for fear of losing foreign investments from signatory nations.⁷⁹ Some countries were concerned that signing the MAI could even become a requirement for receiving financial assistance from organizations such as the World

⁷⁵Dattu 2000, at 276; Mabey 1999, at 63; Crane 1998, at 431.

⁷⁶Walter 2001, at 60. According to Muchlinski 2001, at 121, the WTO was also preferred by the European Community because in that forum it had direct negotiating rights on behalf of its Member States.

⁷⁷“The Sinking of the MAI,” *The Economist* 2004 (346), at 81-2.

⁷⁸*Ibid.*

⁷⁹Crane 1998, at 436.

Bank and IMF (which are effectively controlled by OECD countries).⁸⁰

The collapse of the MAI negotiations could also be attributed, at least in part, to a concerted effort on the part of environmental and labour groups to stop, or at least influence the outcome of, the negotiations.⁸¹ Environmental and social issues barely featured at the start of MAI talks but became key points of contention in the end.⁸² Following the leak of a confidential draft of the agreement on the Internet, a broad coalition was formed between environmental NGOs, human rights and consumer advocate groups, trade unions, indigenous peoples organizations, and local governments and communities opposed to the MAI.⁸³ The coalition campaigned for the inclusion of environmental and labour standards in the agreement and also argued that the MAI conflicted with many international commitments that OECD countries had made, including those found in the Rio Declaration and Agenda 21 (see Section 2.2.3).⁸⁴ NGO activities also sparked the interest of the social and environmental ministries of OECD governments that had been excluded from, and often unaware of, the negotiations and the implications of the MAI for their policy areas.⁸⁵ However, even at the height of the discussions on environmental issues in the MAI, only two countries sent delegates of their environmental ministries to the negotiations.⁸⁶

NGOs were particularly concerned that provisions on expropriation and investor-state dispute settlement would allow corporations to challenge domestic laws and standards that could be shown to have the equivalent effect of expropriation. Given their experience with Chapter 11 of the NAFTA, it was American and Canadian NGOs that provided the strongest opposition to the MAI.⁸⁷ In fact, the settlement of a particular investor-state dispute (*Ethyl v. Canada*, see Section 5.1.1), which seemed to indicate that certain provisions included in the MAI could be interpreted in unexpected ways, lent support to the NGO position and may have

⁸⁰ *Ibid.*, at 437.

⁸¹ Mabey 1999, at 61; Muchlinski 2001, at 132

⁸² "The Sinking of the MAI," *The Economist* 2004 (346), at 81-2.

⁸³ Henderson 1999, at 27.

⁸⁴ Crane 1998, at 439.

⁸⁵ Mabey 1999, at 64.

⁸⁶ *Ibid.*

⁸⁷ Walter 2001, at 62.

influenced the MAI drafters.⁸⁸

Walter argues that the push from NGOs for labour and environmental standards to be included in the MAI led to a weakening support for the agreement from business lobbies, which in turn eventually led to the demise of the entire process.⁸⁹ However, there were also other complicating factors: business lobbies were pushing for provisions related to taxation, which governments strongly opposed; and the French and Canadian governments wanted 'cultural industries' to be exempted from the agreement, which was unpopular with the American business lobby in particular.⁹⁰ Other 'deal-breakers' concerned the US desire to introduce provisions on the rights of owners of illegally-expropriated property to pursue claims against the current owners of that property, and the EU position on the need for an exemption for 'regional economic integration organizations' from certain provisions.⁹¹ In contrast to the general feeling in 1995 that negotiating an agreement among such 'like-minded' countries should be relatively easy, over the three years of negotiations it became quite evident that there were substantial differences between OECD countries with regard to their views on investment protection.

Since that time, efforts to negotiate a multilateral agreement on investment within the WTO have also failed rather spectacularly. In fact, most recently, efforts to launch negotiations at the 2003 WTO Ministerial Conference in Cancún were blocked by developing countries who argued that investment protection should only be considered if there was also agreement to expand the discussions to corporate conduct and liability.⁹² Following Cancún, the EU continued to push for optional investment negotiations on a plurilateral basis, despite diverging views on this position amongst EU member countries.⁹³ On 1 August 2004, the General Council of the WTO adopted a Decision on the so-called July Package, which

⁸⁸Newcombe 2007b, at 392; Sornarajah 2004a, at 293; Muchlinski 2001, at 128.

⁸⁹Walter 2001. See also Sikkil 2001.

⁹⁰Muchlinski 2001, at 130; Walter 2001, at 62; Malanczuk 2000, at 418; UNCTAD 1999b, at 23-2.

⁹¹Muchlinski 2001, at 129-30.

⁹²Kerremans 2004, at 363; Sornarajah 2004a, at 28.

⁹³The United Kingdom (UK) has argued that it would be better to remove investment from the WTO agenda altogether. See Peterson 2004b, at 1.

broke the Cancún deadlock.⁹⁴ This Decision makes it clear that investment will not be an issue for negotiation within the WTO in the Doha Round.⁹⁵

The Rise of the Bilateral Investment Treaty

Although BITs were around long before the MAI (the first known BIT was signed in 1959 between West Germany and Pakistan), it is only recently that the negotiation and enforcement of these agreements have become widespread. There are now more than 2,500 BITs worldwide.⁹⁶

The first BITs were created to deal with the period of uncertainty following decolonization, and the main purpose of BITs today is still to protect foreign investors in the developing world. OECD countries participate in BITs almost exclusively with developing countries; while there is an increasing number of South-South BITs, there is a dearth of IIAs between industrialized nations.⁹⁷

The main provisions on investment protection found in BITs, that are of relevance in this study, are national treatment, most-favoured-nation treatment, the international minimum standard of treatment, fair and equitable treatment, full protection and security, expropriation, performance requirements, and access to international investment arbitration, although not every treaty covers all of these provisions (see Chapter 4). BITs typically last for ten years, with an automatic extension of this term unless a party files notice to terminate the treaty. It is also typical for there to be a period following the termination of an agreement in which the provisions continue to apply to existing investments.⁹⁸ As most BITs are of a relatively recent vintage, there is little experience with their expiry or termina-

⁹⁴“The July 2004 Package,” *WTO website*, <http://www.wto.org>.

⁹⁵Specifically, it includes a paragraph on the Relationship between Trade and Investment, Interaction between Trade and Competition Policy and Transparency in Government Procurement stating that “the Council agrees that these issues, mentioned in the Doha Ministerial Declaration in paragraphs 20-22, 23-25 and 26 respectively, will not form part of the Work Programme set out in that Declaration and therefore no work towards negotiations on any of these issues will take place within the WTO during the Doha Round.”

⁹⁶Not all BITs have entered into force. UNCTAD 2006d estimates that of the 2,495 BITs concluded prior to 2006, 1,891 (i.e. 75.8%) had entered into force.

⁹⁷Garcia 2004, at 315; Hallward-Driemeier 2003, at 8.

⁹⁸Reed *et al.* 2004, at 61.

tion.⁹⁹

Despite the large number of BITs, these agreements have enjoyed a relatively low profile in comparison with regional trade and investment agreements such as the NAFTA, and the controversial and well-publicized attempts of states to develop a multilateral agreement on investment. This is now beginning to change, as Spierrmann notes:

The times are gone when bilateral investment treaties could be treated as ‘mainly bureaucrats’ treaties’ tucked away from the hustle and bustle of the financial world.¹⁰⁰

Part of the reason for the increased interest in BITs is the sudden and dramatic rise in investor-state disputes.

Investor-State Dispute Settlement

Prior to the modern period, most disputes between investors and states were resolved locally, in the domestic courts of the host state and under domestic law. Local remedies have a variety of advantages for the host state; in particular they are considerably less costly, both financially and in terms of reputation.¹⁰¹ On the other hand, foreign investors have consistently argued that local courts in developing countries are ill-equipped to deal with investment disputes and, furthermore, that if asked to adjudicate claims brought against their own state these courts “may hardly be able to resist the political pressure inherent in this situation.”¹⁰²

Historically, an investor’s only alternatives to local remedies were to attempt to bring a case in a foreign court or to endeavor to convince his home state to either apply diplomatic pressure or bring the claim on his behalf before an international tribunal. A number of obstacles can preclude remedy in a foreign court, such as sovereign immunity.¹⁰³ Choi notes that diplomatic protection is also unde-

⁹⁹*Ibid.*, at 62.

¹⁰⁰Spierrmann 2004, at 179.

¹⁰¹Dodge 2000, at 361.

¹⁰²Bernardini 2001, at 246.

¹⁰³Bankas 2005, at vii-viii, notes that historically states have been immune from the judicial process and enforcement jurisdiction of municipal courts, although in recent years some restrictions have been placed on the concept. See also Dodge 2000, at 358; Cook 2007, at 1095.

sirable for many reasons; in particular, it tends to politicize disputes and increase international friction, and introduces power differences that inevitably affect the resolution of the dispute.¹⁰⁴ Others argue that investors simply cannot rely on home states to bring claims on their behalf, because they are rarely willing to do so and, when they are, it is often for political reasons rather than on the basis of a sound evaluation of the merits of the investor's claim.¹⁰⁵

As noted above, in the 1960s and 1970s, a substantial debate emerged over the 'internationalization' of state contracts. While the validity of the theory of the internationalization of state contracts has been challenged,¹⁰⁶ with the advent of IIAs the local remedies rule has, in any case, largely been supplanted by recourse to international arbitration.¹⁰⁷ Customary international law requires the exhaustion of local remedies before a foreign investor's claim may be brought before an international tribunal, but this rule may be waived by international agreement.¹⁰⁸ Few IIAs require the exhaustion of local remedies prior to the commencement of the arbitration process, and some agreements require the investor to choose its avenue of dispute settlement from the outset. In addition, state contracts that refer to local remedies may nevertheless be subsumed under IIAs in certain circumstances (see further Section 4.1.6).

Van Harten argues that the removal of the duty to exhaust local remedies has several, perhaps unanticipated, implications: firstly, domestic courts are no longer presumed to be capable of delivering justice; secondly, investors, unlike other foreign nationals, are no longer assumed to have a duty to take into account the domestic means to redress wrongs; and thirdly, the host state's legal system is denied the opportunity to correct any wrongs to a foreign investor before they become an issue of international responsibility.¹⁰⁹ Ginsburg goes so far as to suggest that as access to international arbitration allows powerful players to exit the local jurisdiction, it removes an important source of support for efforts to improve domestic court systems and can even, under certain conditions, result in

¹⁰⁴Choi 2007, at 727-8.

¹⁰⁵Brower 2003, at 89.

¹⁰⁶Sornarajah 2003, at 175.

¹⁰⁷Baruti Dames 2005, at 530.

¹⁰⁸Dodge 2000, at 363.

¹⁰⁹Van Harten 2007a, at 110.

a reduction of local institutional quality.¹¹⁰

A plethora of investor-state disputes have been resolved in international arbitration in the last decade. The cumulative number of all *known*¹¹¹ treaty-based cases was 255 as of November 2006.¹¹² This can be compared to the end of 1994 when there were only five known treaty-based cases. At least 70 governments (44 in the developing world) have faced investment arbitration.¹¹³

2.2 A Brief History of Environmental Protection

2.2.1 The Colonial Period: Pre-1945

As with the protection of foreign investment, the protection of the environment has only been a major political issue since the Industrial Revolution. While environmental issues certainly existed prior to the industrialized age, the potential for human beings to alter the environment has increased rapidly with the development of modern technology.

It is now recognized that colonialism and imperialism had profound environmental consequences.¹¹⁴ The colonies were used as a source of raw materials for the developed world, but also as a ‘testing ground’ for emerging policies of environmental management, particularly in the area of nature and wildlife conservation. Traditional methods of nature conservation in the colonies were viewed as ignorant and wasteful and were substituted with Western concepts implemented by colonial governments.¹¹⁵

Resource exploitation dominated the agenda in colonial times.¹¹⁶ The main issue of environmental concern in the period, as defined by the colonial powers, was nature conservation and in particular the management of wildlife.¹¹⁷ Regu-

¹¹⁰Ginsburg 2005. For an opposing opinion see Franck 2007.

¹¹¹As further discussed in Chapter 4, not all cases are disclosed to the public.

¹¹²UNCTAD 2006c, at 2. This does not include cases brought on the basis of a state contract.

¹¹³*Ibid.*

¹¹⁴Clapp and Dauvergne 2005, at 47.

¹¹⁵*Ibid.*; Barrow 2005, at 33.

¹¹⁶Barrow 2005, at 33.

¹¹⁷Clapp and Dauvergne 2005, at 47; Adams 1990, at 19.

lating foreign investment was not an issue within the colonies (as any investors were likely to originate from the colonial powers) and outside of the colonies the focus was on the economic control of industries, as described above, rather than on environmental protection.

2.2.2 The Post-Colonial Period: 1945-1980

It was not until the post-colonial period that environmentalism rose as an issue of substantial concern in the developed world. The origins of the movement were largely rooted in public opposition to nuclear weapons and chemical pollution; the products of industrialization and technological development. In developing countries much of the focus remained on development and control of natural resources, and Northern concepts of environmental protection were treated with a degree of suspicion. The concern of many government officials was not simply that protecting the environment might come at some economic cost, but that the environmental agenda would be used as a guise by developed countries to maintain control over resources and technology and even hinder development in the South.¹¹⁸

In this period, the notion of the global environment or the global commons also emerged for the first time and, as a result, some multilateral efforts aimed at protecting the environment were initiated. Other multilateral processes which addressed a wide range of issues, including corporate conduct, also covered environmental protection.

The UN Conference on the Human Environment

In response to the emergence of global environmental concern, the first global conference on the environment was held in Stockholm, Sweden, in June 1972.¹¹⁹ Delegates from 113 governments attended the UN Conference on the Human Environment (UNCHE). According to Adams, the focus of the conference was on the classic concerns of developed countries, such as pollution, whilst the environ-

¹¹⁸Porter *et al.* 2000, at 179.

¹¹⁹Clapp and Dauvergne 2005, at 54.

mental and developmental problems of the South were addressed only partially and belatedly.¹²⁰

One of the most significant outcomes of the Conference was the creation of the United Nations Environment Programme (UNEP) in 1972 by the UN General Assembly to be based in Nairobi, Kenya. The Declaration of the Conference also codified several important principles of international environmental law.¹²¹ Principles that were most relevant to developing countries were: Principle 8, which suggested that development was needed to improve the environment; Principles 9, 10 and 12, which covered the need of developing countries for assistance (technical and financial) and for reasonable prices for exports; Principle 11, which stipulated that development need not be impaired by environmental protection; Principles 13 and 14, which addressed 'integrated development planning' and planning to avoid/resolve development-environment conflicts; and Principle 21, which affirmed states' permanent sovereignty over their natural resources. However, of the 109 Recommendations for Action, only eight addressed the relationship between development and the environment.¹²²

The UN Commission on Transnational Corporations

The first major attempt to codify the duties of TNCs began in 1974, when the UN Commission on Transnational Corporations (UNCTC) was established under the auspices of the Economic and Social Council (ECOSOC). The Commission was composed of 48 members from all geographic regions. The highest priority for the UNCTC was the development of a code of conduct for TNCs, and negotiations began on this issue in 1977. The UNCTC Code was intended to define both the rights and responsibilities of states and TNCs in a balanced manner.¹²³ In the mid-1980s the UNCTC began to work on environmental aspects of TNC activity.¹²⁴

Part B of the UNCTC Code contained three provisions relating to environ-

¹²⁰ Adams 1990, at 36-7.

¹²¹ Report of the United Nations Conference on the Human Environment, 5-16 June 1972, Stockholm, UN Doc. A/CONF/48/14/REV.1, <http://www.unep.org/>.

¹²² Recommendations 102-109.

¹²³ Correa and Kumar 2003, at 32.

¹²⁴ Hansen 2002, at 162.

mental protection, which covered:

- Adhering to national environmental laws and regulations, policies and practices;
- Giving due regard to international environmental standards;
- Taking steps to protect the environment and rehabilitate it when it is damaged;
- Supplying relevant information to the competent authorities related to the possible environmental impacts of products and services and measures necessary to avoid or mitigate environmental harm, as well as any prohibitions or other public regulatory measures that are imposed in other countries with respect to these products/services; and
- Being responsive to requests from governments and international organizations to cooperate in efforts to develop and promote national and international environmental standards.¹²⁵

The UNCTC also issued a series of 14 ‘criteria for sustainable development management’ in 1989, and prepared a set of recommendations on TNC conduct in the run-up to the 1992 Earth Summit (see further below).¹²⁶ However, the recommendations were considered too controversial and were dropped from the Summit’s agenda.¹²⁷

Due to opposition from developed countries, an economic recession, and the debt crisis, the drive to adopt the UNCTC Code faded in the 1980s.¹²⁸ Despite an attempt to revive it in 1990, the UNCTC was officially dismantled in 1992. Some of its work was carried on by UNCTAD, which remains an important forum for discussion on TNC regulation (as well as investment protection), but the UNCTC Code was abandoned altogether.

2.2.3 The Modern Period: 1980-Present

With the demise of the UNCTC, and the dramatic shift of developing countries toward actively seeking FDI, the notion of corporate accountability has been put on

¹²⁵Draft UNCTC Code, at paras. 43-5.

¹²⁶Hansen 2002, at 162.

¹²⁷*Ibid.*, at 163.

¹²⁸*Ibid.*

the back-burner of international politics in the modern period. In its place, the notion of 'corporate social responsibility', the process whereby companies "integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis," has gained prominence.¹²⁹ As Utting explains:

The confrontational politics of earlier decades, which had pitted a pro-regulation and redistributive lobby against TNCs, lost momentum as governments, business and multilateral organizations alike, as well as an increasing number of NGOs, embraced ideas of 'partnership' and 'co-regulation' in which different actors or 'stakeholders' would work together to find ways of minimizing the environmental cost of economic growth and modernization. The hands-on regulatory role of the state ceded ground to 'corporate self-regulation' and 'voluntary initiatives' as the best approach for promoting the adoption of instruments and processes associated with corporate environmental responsibility.¹³⁰

At the same time, environmental problems have become more and more recognized as serious political issues, in need of global action. The modern period has had two major 'Earth Summits', and by 2007 over 900 multilateral environmental agreements (MEAs) and at least 1500 bilateral ones had been developed.¹³¹ However, these agreements typically lack strong enforcement mechanisms.

The ties between environmental issues and other issues relating to development were increasingly strengthened in the modern period through the notion of sustainable development. However, despite the growing integration of issues of environment and development, global environmental governance retains a strong North-South dimension. For example, numerous politically contentious issues have arisen between developed and developing countries in the areas of climate change,¹³² food governance,¹³³ and the transboundary movement of hazardous wastes.¹³⁴

¹²⁹European Commission 2001, at 8.

¹³⁰Utting 2002, at 1.

¹³¹See the International Environmental Agreements Database Project website developed by Ronald Mitchell, <http://iea.uoregon.edu/page.php?file=home.htm&query=static>, accessed 4 January 2008.

¹³²See generally Gupta 1997.

¹³³See generally Gupta 2004.

¹³⁴See generally Porter *et al.* 2000, at 103-8.

The Brundtland Report

The World Commission on Environment and Development (WCED), informally referred to as the 'Brundtland Commission' (after its chairman Gro Harlem Brundtland, former Prime Minister of Norway), was established in 1983 by the UN General Assembly. The Commission was created to address growing concern about environmental degradation and its relationship to development.

The report emanating from the WCED, entitled *Our Common Future*, is perhaps most famous for its articulation of the concept of sustainable development as "development which meets the needs of the present without compromising the ability of future generations to meet their own needs."¹³⁵ With regard to the present topic, Section 3.3 on 'Ensuring Responsibility in Transnational Investment' is particularly relevant.

The report noted that while developing countries have become more open to inflows of FDI, mutual suspicions still existed between these countries and TNCs, usually a result "of an asymmetry in bargaining power between large corporations and small, poor, developing countries."¹³⁶ The report suggested that developing countries lacked information and technical preparedness to deal with TNCs, and suffered from political and institutional weaknesses.¹³⁷ It was therefore argued by the Commission that regional and international organizations should assist developing countries in negotiations with foreign investors, for example by producing model contracts.¹³⁸ It was also suggested that TNCs should adopt 'home country standards'.¹³⁹

Finally, the Brundtland report noted that international measures aimed at regulating TNCs "have been generally lacking and have proved extremely difficult to negotiate" and recommended that the codes of conduct for transnational corporations formulated by the OECD (see below) and under discussion in the UN (UNCTC Code) should deal explicitly with environmental matters and the objec-

¹³⁵ World Commission on Environment and Development (WCED) 1987, at 43.

¹³⁶ *Ibid.*, at 86.

¹³⁷ *Ibid.*

¹³⁸ *Ibid.*

¹³⁹ *Ibid.* See further below.

tive of sustainable development.¹⁴⁰

The Rio Declaration and Agenda 21

The UN Conference on Environment and Development (UNCED) took place in Rio de Janeiro, Brazil, in 1992. The event, also commonly referred to as the 'Earth Summit', was attended by 172 governments. The business lobby was also heavily involved in the activities surrounding the UNCED. Particularly notable was the presence of the newly formed Business Council for Sustainable Development (BCSD), which later merged with the World Industrial Council for the Environment (WICE), to become the World Business Council for Sustainable Development (WBCSD).

Major outcomes of the UNCED included the Rio Declaration on Environment and Development¹⁴¹ and Agenda 21,¹⁴² as well as the UN Framework Convention on Climate Change,¹⁴³ the Convention on Biological Diversity (CBD),¹⁴⁴ and the non-binding 'Forest Principles'.¹⁴⁵

As the Stockholm Declaration had done 20 years prior, the Rio Declaration included the principle of permanent sovereignty over natural resources and emphasized the need to integrate environmental considerations into development planning.¹⁴⁶ Furthermore, the Declaration stressed the need for capacity-building for sustainable development.¹⁴⁷ The Declaration also espoused the 'precautionary principle' (or approach), stipulating that:

¹⁴⁰*Ibid.*

¹⁴¹Rio Declaration on Environment and Development, 14 June 1992, Rio de Janeiro, <http://www.unep.org>. Reproduced in 31 *ILM* (1992), at 874.

¹⁴²Agenda 21, Report of the UN Conference on Environment and Development, 3-14 June 1992, Rio de Janeiro, UN Doc. A/CONF.151/26/ Rev.1 (Vol. 1), Annex II, <http://www.unep.org>.

¹⁴³UN Framework Convention on Climate Change, 9 May 1992, New York, <http://unfccc.int>. Reproduced in 31 *ILM* (1992), at 851.

¹⁴⁴Convention on Biological Diversity, 5 June 1992, Rio de Janeiro, <http://www.cbd.int>. Reproduced in 31 *ILM* (1992), at 818.

¹⁴⁵Non-Legally Binding Authoritative Statement of Principles for a Global Consensus on the Management, Conservation and Sustainable Development of all Types of Forests, 14 June 1992, Rio de Janeiro, <http://www.un.org/esa/forests>. Reproduced in 31 *ILM* (1992), at 1333.

¹⁴⁶Principles 2 and 4 respectively.

¹⁴⁷Principle 9.

Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation.¹⁴⁸

The ‘polluter pays’ principle was also included in the Declaration:

National authorities should endeavour to promote the internalization of environmental costs and the use of economic instruments, taking into account the approach that the polluter should, in principle, bear the cost of pollution, with due regard to the public interest and *without distorting international trade and investment*.¹⁴⁹

The emphasized text represents a significant caveat to the polluter pays principle, given that, as Wälde notes, “[i]t is hard to consider an example of pollution where full liability would not in some way ... distort investment or affect international trade.”¹⁵⁰

Agenda 21, the plan of action emanating from the UNCED, covered a wide range of environmental issues and laid out steps that needed to be taken globally, nationally, and locally, to address them. Chapter 2 of the plan noted that:

Investment is critical to the ability of developing countries to achieve needed economic growth to improve the welfare of their populations and to meet their basic needs in a sustainable manner, all without deteriorating or depleting the resource base that underpins development. Sustainable development requires increased investment, for which domestic and external financial resources are needed. Foreign private investment and the return of flight capital, *which depend on a healthy investment climate*, are an important source of financial resources.¹⁵¹

Chapter 30 was entitled Strengthening the Role of Business and Industry and was divided into two program areas: promoting cleaner production, and promoting responsible entrepreneurship. The second program area, which is particularly relevant, had two objectives: to encourage the concept of stewardship in the management and utilization of natural resources by entrepreneurs, and to increase the

¹⁴⁸Principle 15.

¹⁴⁹Principle 16.

¹⁵⁰Wälde 1998b, at 243.

¹⁵¹Agenda 21, at para. 2.23, emphasis added.

number of entrepreneurs engaged in enterprises that subscribe to and implement sustainable development policies.¹⁵² Business and industry were encouraged to participate in a number of activities including the development of world-wide corporate policies on sustainable development. According to Hansen, the elimination of all but these few ambiguous and non-binding recommendations referring to TNCs in Agenda 21 was, for many observers, “a prime example of the business community capturing the international environmental agenda.”¹⁵³

The Global Compact

The shift away from the corporate *accountability* approach toward the softer corporate *responsibility* approach in the modern period is perhaps best exemplified by the Global Compact. This initiative was launched at the World Economic Forum in Davos, Switzerland, in 1999, by then UN Secretary-General Kofi Annan. The Compact is aimed at bringing together large TNCs and the UN to make globalization more equitable and sustainable.¹⁵⁴ The original Compact was based on nine principles, three drawn from each of the following: the Universal Declaration of Human Rights; the International Labour Organisation’s (ILO) Fundamental Principles and Rights at Work; and the Rio Declaration. In 2004 a tenth principle, dealing with anti-corruption, was added to the list. The three environmental principles cover general environmental responsibility, the precautionary principle, and the development and dissemination of environmentally friendly technologies.

While many welcomed the initiative as a creative step, NGOs generally viewed the Compact as not only ineffective, but also potentially dangerous as it could act as a ‘bluewash’ for companies with poor social and environmental records. According to Bruno and Karliner, “notorious violators” of the Compact’s principles are active participants in the Compact.¹⁵⁵

On the other hand, John Ruggie, who acted as Assistant Secretary-General

¹⁵²*Ibid.*, at para. 30.18.

¹⁵³Hansen 2002, at 163.

¹⁵⁴“Blue Washed and Boilerplated,” *The Economist* 2004 (371), at 61-2.

¹⁵⁵Bruno and Karliner 2002, at 35. For example, the mining company Rio Tinto is a participant in the Compact, and is also accused of numerous human rights and environmental abuses related to its operations in Indonesia.

and Chief Adviser for Strategic Planning to Kofi Annan from 1997 to 2001, argues that the critics are seriously underestimating the Compact's potential, while also acknowledging that its supporters may be holding excessive expectations for what the initiative can achieve.¹⁵⁶ Ruggie claims that the principal role of the Compact is to act as a learning forum for corporations. According to Ruggie, the UN launched the Global Compact rather than attempting to initiate negotiations on a binding set of rules of corporate conduct for several reasons: (i) countries were not interested in adopting a meaningful code of conduct at the time; (ii) the logistical and financial requirements to monitor global companies and their supply chains far exceeded the capacity of the UN; (iii) the business community would have opposed the imposition of a code of conduct and even progressive business leaders would have been drawn into an anti-code coalition; (iv) many principles of human rights, labour rights, and environmental stewardship could not be precisely defined at the time; and (iv) the pace of change in corporate strategies, structures, and production processes made it exceedingly difficult to specify what desired/prohibited practices a code should have included.¹⁵⁷

The Revised OECD Guidelines on Multinational Enterprises

The OECD Guidelines for Multinational Enterprises are part of the 1976 Declaration on International Investment and Multinational Enterprises and associated Decisions of the OECD Council (which also covers national treatment, investment incentives, and conflicting requirements).¹⁵⁸ The Guidelines consist of voluntary principles and standards relating to employment and industrial relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition, and taxation. The Guidelines are addressed to TNCs operating in, or from, countries that have adopted them.¹⁵⁹ The Guidelines were reviewed in 2000, and updated to reflect the shift in the international community to a sustainable development agenda.

¹⁵⁶Ruggie 2001, at 371.

¹⁵⁷*Ibid.*, at 373.

¹⁵⁸The OECD Declaration and Decisions on International Investment and Multinational Enterprises: Basic Texts, DAF/IME(2000)20, <http://www.oecd.org>.

¹⁵⁹All of the OECD countries and 10 non-OECD countries are signatories.

Section V on the environment states that enterprises should “take due account of the need to protect the environment” and “generally conduct their activities in a manner contributing to the wider goal of sustainable development.” To achieve this they should, in general, take heed of domestic laws and regulations as well as international agreements, principles, objectives, and standards. More specifically they should:

- Establish and maintain a system of environmental management;
- Provide timely information on environmental impacts of their activities and communicate and consult with communities that are directly affected by these activities;
- Address environmental impacts in decision-making and prepare EIAs;
- Not use the lack of scientific certainty as a reason for postponing cost-effective measures to prevent or minimize environmental damage (precautionary principle);
- Plan for environmental accidents and emergencies;
- Improve environmental performance through improved technologies, research, development of environmentally friendly products, and the promotion of consumer awareness;
- Educate and train employees in environmental health and safety matters; and
- Contribute to the development of environmentally meaningful and economically efficient public policy (e.g., partnerships, awareness-raising initiatives, etc.).¹⁶⁰

The Guidelines contain a mechanism of implementation: National Contact Points are set up in each country that endorses the Guidelines to receive complaints about companies. However, this mechanism is considered largely ineffective.¹⁶¹ According to Jenkins, “the OECD Guidelines did not represent a genuine

¹⁶⁰OECD Guidelines, at paras. V.1-8.

¹⁶¹In 2002, the UN Expert Panel on Illegal Exploitation of the Natural Resources of the Democratic Republic of the Congo named 85 companies in breach of the OECD Guidelines, but no significant action was taken by governments to respond. See “Illegal Exploitation of Natural Resources in the Democratic Republic of Congo,” *Public Statement by the OECD Committee on International Investment and Multinational Enterprises*, 12 February 2004, <http://www.oecd.org>.

attempt to control transnationals, but was rather designed to deflect criticism of their activities.”¹⁶²

The World Summit on Sustainable Development

The 10-year follow-up to the Rio Earth Summit was the World Summit on Sustainable Development (WSSD) held in Johannesburg, South Africa, in 2002. Tens of thousands of participants, from heads of state and government to representatives of NGOs and businesses, attended the 10-day meeting.

The Report of the WSSD made reference to ‘investment’ 56 times, and while the use of this term can certainly also encompass investment by the public sector, the emphasis in the report is clearly on the private sector.¹⁶³ In developing countries, this most often means the involvement of foreign investors. Three paragraphs in the document are worth noting. In the Political Declaration, it was suggested that globalization had added a new dimension to the complexity of the issue of sustainable development and remarked that, among other things, “significant increases in investment flows around the world have opened new challenges and opportunities for the pursuit of sustainable development.”¹⁶⁴ While this paragraph made reference only to the “challenges and opportunities” of foreign investment itself, the Plan of Implementation additionally noted the need for “an enabling environment for investment,” which was viewed, as a part of good governance, as “the basis for sustainable development.”¹⁶⁵ Finally, the Plan of Implementation calls for the creation of:

*the necessary domestic and international conditions to facilitate significant increases in the flow of foreign direct investment to developing countries, in particular the least developed countries, which is critical to sustainable development, particularly foreign direct investment flows for infrastructure development and other priority areas in developing countries to supplement the domestic resources mobilized by them.*¹⁶⁶

¹⁶²Jenkins 2001, at 4.

¹⁶³Report of the World Summit on Sustainable Development, Johannesburg, South Africa, 26 August–4 September 2002, UN Doc. A/CONF.199/20, <http://www.un.org/esa/sustdev>.

¹⁶⁴Political Declaration, at para. 14.

¹⁶⁵Plan of Implementation, at para. 4.

¹⁶⁶*Ibid.*, at para. 84(a), emphasis added.

The WSSD Report also made reference to corporate responsibility. The Political Declaration stated that the signatories, “agree that there is a need for private sector corporations to enforce corporate accountability, which should take place within a transparent and stable regulatory environment.”¹⁶⁷ In the Plan of Implementation states are urged to “enhance corporate environmental and social responsibility and accountability,” including actions to encourage:

- Improvement in the social and environmental performance of industry through voluntary initiatives, including environmental management systems, codes of conduct, certification and public reporting on environmental and social issues;
- Dialogue between enterprises and the communities in which they operate and other stakeholders;
- Incorporation of sustainable development considerations into the decision-making processes of financial institutions; and
- Workplace-based partnerships and programs, including training and education programs.¹⁶⁸

The focus thus clearly remained on voluntary initiatives. Perhaps the most promising paragraph in the Plan of Implementation, from the perspective of advocates of binding rules for TNCs, called on governments to:

Actively promote corporate responsibility and accountability, based on the Rio principles, including through the full development and effective implementation of intergovernmental agreements and measures, international initiatives and public-private partnerships and appropriate national regulations, and support continuous improvement in corporate practices in all countries.¹⁶⁹

According to Morgera, the WSSD outcomes played a significant role in expanding the scope of corporate responsibility beyond environmental concerns (the

¹⁶⁷Political Declaration, at para. 29.

¹⁶⁸Plan of Implementation, at para. 18.

¹⁶⁹*Ibid.*, at para. 49.

focus of Chapter 30 of Agenda 21) and importantly emphasized action on the international, rather than strictly the national level.¹⁷⁰ However, others view the provisions as “weak and permissive,” arguing that corporate influence in the development of the Plan undermined the efforts of NGOs and some governments to launch negotiations on a binding agreement on corporate accountability.¹⁷¹

The UN Norms on the Responsibilities of Transnational Corporations and other Business Enterprises with regard to Human Rights

The UN Norms on the Responsibilities of Transnational Corporations and other Business Enterprises with regard to Human Rights (UN Norms) were adopted by the UN Sub-Commission on the Promotion and Protection of Human Rights in August 2003.¹⁷²

The UN Norms are focused on human rights, but they also relate to environmental protection:

Transnational corporations and other business enterprises shall carry out their activities in accordance with national laws, regulations, administrative practices and policies relating to the *preservation of the environment* of the countries in which they operate, as well as in accordance with relevant international agreements, principles, objectives, responsibilities and standards with regard to the environment as well as human rights, public health and safety, bioethics and the *precautionary principle*, and shall generally conduct their activities in a manner contributing to the wider goal of *sustainable development*.¹⁷³

The Commentary on the UN Norms, provided in a separate report, lays out in further detail what this paragraph is meant to entail.¹⁷⁴ According to the Commentary, TNCs and other businesses are expected to:

¹⁷⁰Morgera 2004, at 219.

¹⁷¹Steiner 2003, at 36. See also “Summary of the World Summit on Sustainable Development,” *Earth Negotiations Bulletin* 22(51), 6 September 2002.

¹⁷²Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights, UN Doc. E/CN.4/Sub.2/2003/12/Rev.2 (2003), <http://www1.umn.edu/humanrts/links/norms-Aug2003.html>.

¹⁷³*Ibid.*, at para. 14, emphasis added.

¹⁷⁴Commentary on the Norms on the Responsibilities of Transnational Corporations and Other Busi-

- Respect the right to a clean and healthy environment, concerns for intergenerational equity, internationally recognized environmental standards, and the wider goal of sustainable development;
- Be responsible for the environmental and human health impact of all of their activities;
- Assess the impact of their activities on the environment and human health and in these assessments address the impact of proposed activities on certain groups, such as children, older persons, indigenous peoples and communities (particularly in regard to their land and natural resources), and/or women;
- Distribute assessment reports in a timely manner and in a manner that is accessible to the UNEP and other international bodies, governments, and the public;
- Respect the prevention principle and the precautionary principle, and not use the lack of full scientific certainty as a reason to delay the introduction of cost-effective measures intended to prevent environmental damage;
- Ensure effective means of collecting or arranging for the collection of products that have reached the end of their life-cycle for recycling, reuse and/or environmentally responsible disposal; and
- Take appropriate measures in their activities to reduce the risk of accidents and damage to the environment by adopting best management practices and technologies.¹⁷⁵

Weissbrodt and Kruger suggest that the UN Norms represent:

a landmark step in holding businesses accountable for their human rights abuses and constitute a succinct, but comprehensive, restatement of the international legal principles applicable to businesses with regard to human rights, humanitarian law, international labour law, environmental law, consumer law, anti-corruption law, and so forth.¹⁷⁶

ness Enterprises with Regard to Human Rights, UN Doc. E/CN.4/Sub.2/2003/38/Rev.2 (2003), <http://www1.umn.edu/humanrts/links/commentary-Aug2003.html>.

¹⁷⁵*Ibid.*, at para. G.14.

¹⁷⁶Weissbrodt and Kruger 2003, at 901.

However, while the text details how the UN Norms are to be implemented and provides for independent and transparent monitoring, the Norms do not represent legally binding obligations.

Private and Public-Private Initiatives

While mainly intergovernmental activities aimed at the protection of the environment have been described thus far, private or public-private initiatives have also emerged in the modern period. These initiatives are voluntary and often market-based.¹⁷⁷ One of the most significant initiatives with respect to foreign investment is the development of International Organization for Standardization (ISO) environmental management standards.¹⁷⁸

The ISO 14000 family of standards on environmental management is primarily concerned with what an organization does to “minimize harmful effects on the environment caused by its activities,” and to “achieve continual improvement of its environmental performance.”¹⁷⁹ While the majority of ISO standards are highly specific to a particular product, material, or process, ISO 14000 standards are ‘generic management system standards’, meaning that they can apply to any product or process in any sector. The 14001 standard is the best known in the 14000 series. It basically requires that firms comply with domestic environmental regulation, that they commit to continual improvement and prevention of pollution, and that they set up an environmental management system and have that system audited.¹⁸⁰ By the end of 1999, over 13,000 firms in 75 countries had obtained ISO 14001 certification.¹⁸¹

While it is certainly not the only set of international environmental guidelines

¹⁷⁷ Examples of such regulation include certification and labeling schemes such as those developed by the Forest Stewardship Council. See Pattberg 2007.

¹⁷⁸ The International Organization for Standardization (ISO), established in 1946, is a network of the national standards institutes of 157 countries and the world’s largest developer of standards. In the run up to the UNCED, the ISO set up a Strategic Advisory Group on Environment to look into the possibility of creating environmental management standards. In 1993 the ISO created a new committee on environmental management (TC 207).

¹⁷⁹ “ISO 9000 and ISO 14000,” *ISO Website*, <http://www.iso.org>, accessed 4 January 2008.

¹⁸⁰ Clapp 2005, at 230.

¹⁸¹ Morrison *et al.* 2000, cited in Clapp 2005, at 223.

aimed at corporations,¹⁸² ISO 14001 has gained wide recognition, and according to Clapp it has eclipsed other voluntary initiatives becoming a “condition for firms that wish to compete in the global marketplace.”¹⁸³ However, there are debates about the legitimacy of the ISO (and other such schemes), as it is an industry-dominated body and is lacking transparent and participatory procedures.¹⁸⁴ There are also questions as to the actual value that ISO standards play in improving environmental conditions. For example, Cléménçon points out that:

ISO 14001 certification of a company does not require the company to set verifiable environmental quality targets and does not require standardized reporting or provide for outside environmental performance reviews. Environmental groups have therefore criticized the voluntary ISO 14001 standardization as little more than a labeling ploy of many companies to gain access to Northern markets.¹⁸⁵

ISO 14001 has also been said to provide little incentive for firms to go beyond the minimum requirement of meeting domestic laws and regulations.¹⁸⁶

It is difficult to assess the importance of ISO 14001 and other private and public-private initiatives intended to ‘green’ business in the South, because research on this issue in developing countries has been limited.¹⁸⁷ However, in general, voluntary private and public-private initiatives do not “amount to an adequate or appropriate replacement for regulation at the state or international level.”¹⁸⁸

Conditions Tied to Investment Risk Insurance and Project Financing

When companies invest abroad they are likely to insure themselves against certain risks, such as nationalization, expropriation, or other similar measures, and

¹⁸² Other examples include the CERES Principles, <http://www.ceres.org>, and the ICC Business Charter for Sustainable Development, <http://www.iccwbo.org/home/environment/charter.asp>.

¹⁸³ Clapp 2005, at 229-30.

¹⁸⁴ *Ibid.*, at 224.

¹⁸⁵ Cléménçon 2000, at 217.

¹⁸⁶ Gulbrandsen 2004, at 84 and 86.

¹⁸⁷ Utting 2002, at 10.

¹⁸⁸ Newell 2001, at 913. See also Hansen 2002, at 177, who states that “it would be naive to believe that business self-regulation is an alternative to government action.”

war or other armed conflict. The main public sources of investment insurance are: the Multilateral Investment Guarantee Agency (MIGA) (part of the World Bank Group), the Inter-Arab Investment Guarantee Corporation (IAIGC), and various national insurance schemes.¹⁸⁹ Insurance can also be provided by private companies such as Lloyds of London and the American International Group.¹⁹⁰

According to Sornarajah, “[o]fficial insurance companies and banks ... are increasingly wary of assisting multinational corporations that cause massive pollution” and there is “recognition of the duty not to assist corporations which pollute in other states and the possibility of legal responsibility for complicity of those who assist such companies which pollute.”¹⁹¹ As such, many organizations have developed environmental conditions that are tied to the receipt of insurance. For example, according to the MIGA Policy on Social and Environmental Sustainability, the Agency:

strives for positive development outcomes in the private sector projects for which it provides guarantee support. An important component of positive development outcomes is the social and environmental sustainability of projects, which MIGA expects to achieve by applying a comprehensive set of social and environmental performance standards.¹⁹²

In terms of project financing, the Equator Principles were first launched by the International Finance Corporation (IFC) and a small number of banks in 2003 and later revised in 2006.¹⁹³ The Equator Principles apply to all new projects with total project capital costs of US\$10 million or more that are financed by signatory organizations. The Equator Principles relate to: social and environmental assessment; social and environmental standards; action plans and management systems; consultation and disclosure; grievance mechanisms; independent review; covenants (on compliance with host country laws and certain other conditions); and report-

¹⁸⁹E.g., the US Overseas Private Investment Corporation (OPIC), the UK Export Credits Guarantee Department (ECGD), and Export Development Canada (EDC).

¹⁹⁰Kolo 1996.

¹⁹¹Sornarajah 2000, at 364.

¹⁹²“Policy on Social and Environmental Sustainability,” 1 October 2007, <http://www.miga.org>.

¹⁹³“The Equator Principles: A Financial Industry Benchmark for Determining, Assessing and Managing Social & Environmental Risk in Project Financing,” July 2006, <http://www.equator-principles.com>.

ing (by financial institutions on implementation of the principles). The Principles appear to have attracted broad participation, but it is perhaps too soon to be able to assess their impact on the ground.

Home State Measures and Foreign Direct Liability

The term ‘home state measures’ has traditionally referred to measures taken by capital-exporting states to promote flows of investment into developing countries (e.g., the provision of risk insurance, the grant of tax exemptions, etc.).¹⁹⁴ However, there is now a suggestion from many NGOs and some developing countries that home state measures should also extend to the exertion of control over the way that TNCs conduct themselves in host states.¹⁹⁵

One of the ways that home states can influence the behaviour of TNCs is by requiring EIAs of projects before providing insurance, as noted above. Another way is to develop environmental and social policies for their export credit guarantee agencies which support outward FDI. For example, the United Kingdom Export Credit Guarantees Department takes into account the contribution of an investment to sustainable development and to the promotion of human rights and good governance.¹⁹⁶

Home states may also facilitate ‘foreign direct liability’; that is liability for companies in home states for their (or their subsidiaries’) actions in other countries. There are several reasons why it may be advantageous to bring a claim against a parent company in the home state rather than against a local subsidiary in the host state: corporations can organize themselves so that the subsidiary is insolvent, not worth suing, or uninsured; there may be limited access to justice in host country courts; and workers’ compensation schemes may preclude claims by victims against an employer.¹⁹⁷ Bringing a claim in a foreign court is the only option other than a domestic claim as TNCs do not have formal international legal personality and, therefore, do not have standing before any international court.¹⁹⁸

¹⁹⁴Sornarajah 2004a, at 169.

¹⁹⁵Zarsky 2000.

¹⁹⁶UNCTAD 2007b, at 178.

¹⁹⁷Cordonier Segger 2003, at 300.

¹⁹⁸Sornarajah 2000, at 361.

Sornarajah argues that there may be a basis in international law for duty on the part of states to entertain litigation of TNCs based on their activities in foreign states.¹⁹⁹ Because the home state permits hazardous technology or investment to be taken out of its territory it is partially responsible for any harm that may ensue as a result and, therefore, should permit litigation before its courts to reduce or redress the harm. It can also be argued that certain norms of international environmental law have such overwhelming support that domestic courts should provide sanctions for violations of these norms.

Newell suggests that foreign direct liability “provides a potentially vital channel for ensuring that TNCs do not exploit lower environmental standards and poor enforcement regimes at the expense of workers and their environment,” but he also recognizes the limitations of this mechanism.²⁰⁰ The main barrier to foreign direct liability suits is the principle of *forum non conveniens*. Investors can rely on this principle to argue that a court in the host state is a more appropriate venue for the resolution of a dispute than a court in the home state. This barrier proved significant in the Bhopal disaster case, the first case in which foreign direct liability was utilized in order to redress an environmental harm. The Indian government tried to bring a claim against Union Carbide in the US but it was unsuccessful; the court declined jurisdiction on the basis that the courts in India were a more convenient forum. However, according to Sornarajah, since the delivery of this much criticized judgment there has been a greater willingness of courts to extend jurisdiction in similar cases.²⁰¹

Other problems with using litigation to hold investors accountable relate to: the difficulty of establishing cause-effect relationships in cases of environmental damage; the need to ‘pierce the corporate veil’ to establish connections between subsidiaries and parent TNCs; the length of time that the process requires; and the limited capacity of many potential claimants to bring cases.²⁰² Furthermore, as Newell remarks, litigation “reduces complex social problems to questions of monetary compensation.”²⁰³ Thus, despite the potential for foreign direct liability

¹⁹⁹ *Ibid.*, at 363-4.

²⁰⁰ Newell 2001, at 914.

²⁰¹ Sornarajah 2000, at 361.

²⁰² Newell 2001, at 915-6; Ayine and Werksman 1999.

²⁰³ Newell 2001, at 915.

to act as an important tool, particularly in the case of disasters like Bhopal or situations of especially grave abuses of human rights, Cordonier Segger argues that “it would be unrealistic and undesirable” to attempt to resolve all cases of TNC misconduct in this manner.²⁰⁴

2.3 Summary

This brief historical overview illustrates that while the global reach and influence of TNCs continue to rise, the international community has repeatedly failed to address the crucial issue of their regulation. Despite the lack of a multilateral agreement on investment, the legal protection of foreign investment is far more developed at the international level than is the protection of the environment. One can contrast the weak and underdeveloped initiatives for the regulation of foreign investors (where implementation is only possible through national governments and where enforcement mechanisms lack teeth), with the extensive web of binding and enforceable agreements on investment protection. As a result, it can be assumed that conflicts that arise between foreign investors and host states, including those that relate to the protection of the environment, will be resolved in the forums offered by IIAs and state contracts. As such, anyone concerned with environmental governance should take a keen interest in international investment arbitration.

The overview also illustrates that historically there has been a perceptible North-South divide on the issues of the protection and regulation of foreign investment, and the protection of the environment. This divide is neither impermeable nor immutable, but it has not completely disappeared despite dramatic changes in the economic situations of some developing countries. South-South agreements on investment protection have begun to emerge and many countries that formerly only imported capital are now significant exporters of capital. Nevertheless, the backlash to the MAI and the failure of the WTO Ministerial in Cancún tend to suggest that developing countries still occasionally act as a relatively unified bloc on the issue of investment protection. Similarly, while disagreements exist in the North, as evidenced in the failed MAI negotiations, their

²⁰⁴Cordonier Segger 2003, at 302.

desire for increased protection of their investors without accompanying binding rules on corporate conduct is fairly consistent.

Theoretical Framework

The focus of this study is on the relationship between the protection of foreign investment and the protection of the environment. This relationship is complicated by the fact that both areas are bound up in issues of economics, politics, and law. Thus, a study of this nature will invariably have to cross disciplinary boundaries. However, the guiding theoretical approach in this study is derived mainly from international relations/international political economy scholarship, and particularly from critical works that take a *neo-Gramscian* perspective. This chapter introduces the neo-Gramscian approach to international (or more aptly *transnational*) politics and explains why it provides an especially apposite framework for this study. The chapter also defines and delineates the concept of the *institution of investment protection*. It then provides a critical assessment of this institution through the application of neo-Gramscian theory and forms a plan of inquiry for the remainder of the study.

3.1 International Relations Theory

This section reviews several conventional and unconventional approaches to the subjects of international law and non-state actors in international relations. The conventional approaches (neorealism and neoliberal institutionalism) are found

to be dismissive of international law and neglectful of the importance of non-state actors. It is argued that the more unconventional approaches (constructivism, liberalism, and neo-Gramscianism) are more suited to, and capable of, addressing the rapid expansion of international law and the increasing participation of non-state actors in international politics. Neo-Gramscian theory is singled out as the most relevant approach for this study.

3.1.1 International Law and Non-State Actors

In recent years, many international relations scholars have recognized that, “[i]n many issue-areas, the world is witnessing a move to law.”¹ Particularly in areas that affect commerce, law is becoming ubiquitous at the domestic and international levels.² This move to law has been termed the ‘legalization’ of international politics.³ Given the rapid development of IIAs and the shift from diplomatic to legal mechanisms of investor-state dispute settlement, it is evident that the area of foreign investment protection is a key example of legalization. In fact, Kahler suggests that legalization has achieved some of its “most dramatic advances” in the areas of trade and investment.⁴

At the same time, it has been recognized that there has been a significant rise in the number of non-state actors that are, in one way or another, involved in international politics. Over one third of the world’s 100 largest economies are corporations, not states,⁵ and the 200 largest corporations have almost twice the economic clout of the poorest four fifths of humanity.⁶ More than 50,000 international NGOs are currently active,⁷ over 3000 of which have consultative status with the UN.⁸

¹Goldstein *et al.* 2000, at 385.

²Cutler 2003, at 18.

³See the special issue of *International Organization* (vol. 54, issue 3) devoted to the topic.

⁴Kahler 2000, at 667.

⁵Anheier *et al.* 2003, at 9.

⁶Whitman 2002, at 53.

⁷Union of International Associations 2005, at Appendix 3, Table 1.

⁸“Department of Economic and Social Affairs - Non-Governmental Organizations Section,” *UN Department of Economic and Social Affairs website*, <http://www.un.org/esa/coordination/ngo>, accessed 4 January 2008.

While, as empirical developments, the growth of international law and increased numbers of international non-state actors is undeniable, debates continue as to the significance of these developments and the implications for the sovereign state. These debates are discussed below from the perspective of conventional (neorealism and neoliberal institutionalism) and unconventional (constructivism, liberalism, and neo-Gramscianism) approaches in international relations. The perspectives described are ideal-types; the work of individual authors that identify with a given school of thought will often vary considerably in their treatment of these issues.

Conventional Approaches

In a neorealist perspective, where states (the primary unit of interest) are conceived of as rational actors struggling to survive in an anarchical system, international law has no independent basis outside of power politics. For neorealists, international law serves the interests of powerful states, and when it is challenged by such states it proves to be weak and ineffectual.⁹ Neorealists emphasize the importance of consent in international law (states will only agree to be bound by rules that conform to their interests) and the lack of strong enforcement mechanisms. Critics of the neorealist conception of international law argue that it fails to explain the growing body of international law and instances where strong states have clearly been constrained by international legal norms.¹⁰ In addition to viewing international law as an epiphenomena in world politics, neorealists also have a tendency to ignore or downplay the significance of non-state actors.¹¹

Like neorealists, neoliberal institutionalists view states as rational and unitary actors and take state preferences as fixed and exogenously determined. Unlike neorealists, neoliberal institutionalists focus on relative, rather than absolute, gains and suggest that states can cooperate to avoid suboptimal outcomes that emerge under anarchy. In this view, states cooperate through ‘regimes’, or more broadly ‘institutions’, defined as “persistent and connected sets of rules (formal and infor-

⁹Reus-Smit 2004, at 16.

¹⁰*Ibid.*, at 17-8; Stone Sweet 1997, at 138.

¹¹Cutler 2003, at 77.

mal) that prescribe behavioral roles, constrain activity and shape expectations.”¹² Clearly, this broad definition encompasses *legal* institutions. However, because neoliberal institutionalists focus primarily on how institutions can help states overcome collective action problems, they have been criticized for ignoring the way in which international institutions can shape the interests of states, and even their identities.¹³ Furthermore, while this standard definition of institutions does not rule out the participation of non-state actors, these actors have by and large been sidelined in the majority of neoliberal institutionalist accounts.¹⁴

Unconventional Approaches

Constructivists, who reject the rationalist conception of state identities and preferences as stable and exogenous, accord international law greater significance in international relations. Constructivists argue that the demand for institutions (including legal institutions) depends on an actor’s *perception* of international problems, which is, in part produced by their causal and normative beliefs.¹⁵ Thus, it is a state’s perception of its interests which forms the basis for action on the international stage, and in turn, this perception may be influenced by international law. To a constructivist, law is both produced by, and constitutive of, politics.¹⁶ While constructivist insights could also be applied to the interrogation of the identities and preferences of non-state actors, constructivist scholarship primarily focuses on states.¹⁷

Like constructivists, liberal theorists also focus on variation in state preferences.¹⁸ However, their emphasis is on the relationship between domestic politics and state behaviour, the analysis of which they view as necessarily prior to any theory of social construction.¹⁹ Many scholars have recognized that traditional

¹²Keohane 1989, at 3.

¹³Reus-Smit 2004, at 20.

¹⁴Cutler 2003, at 77.

¹⁵Hasenclever *et al.* 1997, at 137.

¹⁶Reus-Smit 2004, at 23.

¹⁷Overbeek 2004, at 114; Tabb 2004, at 31.

¹⁸Moravcsik 1997, at 539.

¹⁹*Ibid.*, at 540.

examinations of international institutions have neglected domestic politics.²⁰ Underhill argues that:

States have legal decision-making power in international and (depending on constitutional arrangements) domestic affairs, and are units in this sense. They are not, however, unified and single-purpose decision-makers because of the ways in which an array of competing coalitions of social forces are integrated into the policy process of the state itself ... The rational choice/unitary state device may well be useful for clarifying a complex situation in a set of international negotiations, for example, but it does not necessarily enhance a general theory of international politics.²¹

While liberals pay particular attention to the “underlying identities, interests, and power of individuals and groups” *within* the state, “who constantly pressure the central decision makers to pursue policies consistent with their preferences,” they also acknowledge that individuals and groups *outside* the state play a role.²² As such, in a liberal perspective, international law is not confined to intergovernmental treaties, but also spans private and transnational lawmaking (see further discussion in Section 3.2.3).²³

In this latter respect, liberal theory is compatible with more critical approaches in international relations theory, which take a keen interest in *transnational* processes (see further below). However, liberalism is often associated, rightly or wrongly, with the belief that international law, as promoted by ‘liberal’ democratic states, is inherently *good* and will influence all states in such a manner as to *improve* domestic governance.²⁴ Critical theorists, particularly those that draw on the writings of Antonio Gramsci, would disagree. Neo-Gramscian scholars argue that it is only the most powerful corporate and economic actors and their allies in government that have a real influence on state behaviour. These actors form a *transnational historic bloc*, which propagates a certain ideology and works to create and bolster institutions that favour the dominant forces in modern capitalism.²⁵

²⁰Martin and Simmons 1998, at 750.

²¹Underhill 2006, at 8.

²²Moravcsik 1997, at 518.

²³Slaughter 2000, at 244-5.

²⁴*Ibid.*, at 246. See Alvarez 2001, for a critique of Slaughter’s liberal theory.

²⁵Cox 1999, at 12; Gill 1998, at 11.

Legal experts play an important role in the transnational historic bloc.²⁶

Like neorealists, neo-Gramscians view international law as undergirded by power structures. However, rather than arguing that international law as ineffectual, neo-Gramscians, like constructivists, consider law as both produced by and constitutive of politics. In a neo-Gramscian perspective, international law, and in particular international *economic* law, serves both to ‘lock-in’ state reforms which favour market forces,²⁷ and to cloak a fundamentally coercive, oppressive, and inequitable global economic system in the rationality and neutrality of law and legal expertise.²⁸ It is argued that legalization is supported by an ideology that is increasingly anti-political and serves to place economic institutions *beyond politics*.²⁹ Furthermore, the types of international legal structures that are emerging are seen as “overwhelmingly on ad hoc, discretionary, closed, and non-transparent.”³⁰ As such, in contrast to many liberal scholars, neo-Gramscians view the trend of legalization as being at odds with the notions of democracy and the rule of law.³¹

3.1.2 A Brief Introduction to Neo-Gramscian Theory

A neo-Gramscian approach is more suited to a study such as this, which is heavily focused on international law and the role of non-state actors in international relations, than conventional approaches. The rational approach of both neorealism and neoliberal institutionalism minimizes the relevance of international law in international relations. Furthermore, as a result of an overriding focus on states, conceptualized as units, the conventional approaches fail to capture the importance of transnational processes and non-state actors. Constructivist and liberal theories overcome many of the shortcomings of conventional approaches. However, each theory alone fails to capture the whole picture. The advantage of neo-Gramscian theory is that it can incorporate both constructivist and liberal insights. In other

²⁶Cutler 2001, at 485.

²⁷Gill 2003, at 167.

²⁸Cutler 2005, at 532.

²⁹Jayasuria 2001, at 452.

³⁰Schuerman 1999, at 3.

³¹*Ibid.*; Schneiderman 2001, at 526.

words, it is a theory that addresses both structure and agency.

A neo-Gramscian approach is also apposite because of the critical nature of this work. According to Cox, while a ‘problem-solving’ theorist “takes the world as given (and on the whole as good)” and is primarily “concerned with the specific reforms aimed at the maintenance of existing structures”, in contrast a ‘critical’ theorist is “concerned with how the existing order came into being” and “with exploring the potential for structural change and the construction of strategies for change.”³²

It should be noted at the outset that it is the scholarship of neo-Gramscians, rather than Gramsci himself, that this study calls upon. Some authors have suggested that neo-Gramscians have employed Gramsci’s ideas in inappropriate ways, in particular by transferring concepts developed at the national level to explain global phenomena.³³ However, as Levy and Newell point out, “Gramsci’s value lies ... in the inspiration he has given to contemporary theorists in their sophisticated treatment of these issues.”³⁴

Hegemony and Historic Blocs

Hegemony is a central concept in a neo-Gramscian understanding of global politics. In this perspective, hegemony is not confined to the traditional notion of the dominance of a state in the international system, but is broadened to involve other “societal groups, economic structures, and concomitant ideological superstructures.”³⁵ An important aspect of hegemony is that it rests on a broad base of consent, rather than depending on the employment of coercion.³⁶ States consenting to be bound by international legal rules which, in turn, constrain their actions is a prime example of the voluntary nature of hegemony. As Egan argues, “instead of capital ‘escaping’ the national state ... capital is more correctly being ‘liberated’ by national states through their participation in the creation of multilateral

³²Cox 1995, at 32.

³³Germain and Kenny 1998.

³⁴Levy and Newell 2005, at 53.

³⁵Levy and Egan 2003, at 806.

³⁶*Ibid.*, at 805; Gill and Law 1989, at 476.

institutions.”³⁷

Hegemony is exercised through ‘historic blocs’ which represent “a historical congruence between material forces, institutions, and ideologies, or broadly to an alliance of different class forces.”³⁸ It should be recalled that the neo-Gramscian conception of a historic bloc is *transnational*. As Overbeek explains:

Transnational processes...are *constituted in a social space transcending national borders* (i.e. their dynamics are not fundamentally defined by the existence of national boundaries...) and take place *simultaneously* in subnational, national *and* international arenas.³⁹

Van Apeldoorn makes an important clarification that while transnational social forces have transcended national boundaries this is not to say that agency no longer occurs in the national context: “by definition transnational social forces do not operate outside states but inside different states at the same time.”⁴⁰

A transnational historic bloc consists not only of TNCs and international organizations but also of government elites.⁴¹ As Cox argues:

Power within the state becomes concentrated in those agencies in closest touch with the global economy – the offices of presidents and prime ministers, treasuries, central banks. The agencies that are more closely identified with domestic clients – ministries of industries, labor ministries, etc. – become subordinated.⁴²

This is part of what Cox termed the ‘internationalization’ of the state, a processes by which national policies and practices are adjusted to the exigencies of the global economy.⁴³ This is a *transformation* of the state, rather than a ‘retreat’ *per se*.⁴⁴ Bieling argues that:

³⁷Egan 2003, at 85.

³⁸*Ibid.*

³⁹Overbeek 2005, at 42.

⁴⁰van Apeldoorn 2004, at 145.

⁴¹Cox 1999, at 12.

⁴²Cox 1997, at 162.

⁴³Cox 1987, at 253.

⁴⁴Strange 1996.

The changing relevancy of particular state agencies – i.e. the up- or down-grading of different kinds of ministries – gives an impression that states are by far not unitary actors. There is at least some evidence to suggest that globalisation and global governance have not generally weakened the state, but rather advanced a business-oriented transformation of statehood.⁴⁵

The process is also not uniform, but will result in “different forms of state corresponding to the different positions of countries in the world economy.”⁴⁶

The New Constitutionalism

Neo-Gramscians argue that the structural power of transnational capital has both a material and an ideological dimension, and consider the two as highly inter-related.⁴⁷ The material dimension is the ability of capital to move - the *exit option* discussed in Section 1.2.1. The ideological dimension is the structuring of hegemony through a set of ‘hegemonic ideas’.⁴⁸ These hegemonic ideas are supported and propagated by historic blocs, but the eventual goal is “the subtle establishment of the prevailing ideology as natural and inevitable, indeed commonsensical.”⁴⁹

Gill refers to the current dominant ideology as ‘disciplinary neoliberalism’.⁵⁰ One key aspect of disciplinary neoliberalism is the notion of competitiveness. States must be stable and credible in the eyes of capital and currency investors, or they will be ‘disciplined’ by the market (e.g. industrial flight).⁵¹ Egan argues that:

The ideological construction of globalization makes it appear reasonable for states to emphasize policies that support ‘competitiveness,’ and this is used to justify weaker or lax enforcement of labor laws and regulations on environmental protection as well as the elimination of restrictions on trade and capital movements.⁵²

⁴⁵ Bieling 2007, at 2-3.

⁴⁶ Cox 1987, at 253.

⁴⁷ van Apeldoorn 2004, at 159; Egan 2003, at 79.

⁴⁸ Gill and Law 1989, at 476.

⁴⁹ Litowitz 2000, at 528.

⁵⁰ Gill 1998.

⁵¹ *Ibid*, at 5.

⁵² Egan 2003, at 79.

Cerny describes the transformation of the traditional nation-state into a ‘competition’ state: a ‘quasi-enterprise association’ that may actually require increased state intervention in certain areas in order to ensure competitiveness and marketization.⁵³ According to Cerny, “[t]he challenge of the competition state is said to be one of *getting the state to do both more and less at the same time*.”⁵⁴ That is to say, the state may be retreating from service and social protection of the public, while it simultaneously increases its role in the securing private property rights and investor freedoms. This thinking is consistent with Gramsci’s argument that the public and the private are complementary spheres of domination, and that in some cases hegemony in the private sphere will only be possible with the provision of public protection by the state.⁵⁵

Gill argues that while ideology and market power are both significant forces, alone they are insufficient to secure the transformation of the state in line with the tenets of neoliberalism.⁵⁶ What is further required is an international governance framework: the politico-legal dimension of disciplinary neoliberalism.⁵⁷ Gill refers to this governance framework as the ‘new constitutionalism’, and argues that “[i]t seeks to separate economic policies from broad political accountability in order to make governments more responsive to the discipline of market forces and correspondingly less responsive to popular-democratic forces and processes.”⁵⁸

Counterhegemony

For neo-Gramscians, civil society is the ground on which hegemony is built, but also the terrain of contestation where a *counterhegemony* could be constructed.⁵⁹ However, there are several significant obstacles to such a development. The first, as Cutler argues, is that counterhegemonic voices may be silenced through a

⁵³Cerny 1997, at 251.

⁵⁴*Ibid.*, at 263, emphasis added.

⁵⁵Litowitz 2000, at 526.

⁵⁶Gill 2003, at 132.

⁵⁷Gill 1998, at 5.

⁵⁸*Ibid.*

⁵⁹Cox 1999, at 3.

knowledge structure that privileges expertise.⁶⁰ Law, in particular, has a tendency to empower particular expertise.⁶¹ A second obstacle is what Gramsci called *transformismo*, which as Cox explains:

can serve as a strategy of assimilating and domesticating potentially dangerous ideas by adjusting them to the policies of the dominant coalition and can thereby obstruct the formation of class-based organized opposition to established social and political power.⁶²

In other words, counterhegemonic voices can be co-opted by the historic bloc. With an understanding of *transformismo*, many neo-Gramscian scholars are skeptical of accounts that champion global civil society in general, and NGOs in particular, as “autonomous social groups balancing the power of states and capital.”⁶³

Despite these obstacles, neo-Gramscians argue that a counterhegemony can be constructed through a ‘war of position’: a long term coordinated strategy that involves the mobilization of multiple bases of power and the development of organizational capacity.⁶⁴

3.2 The Institution of Investment Protection

While this study adopts a neo-Gramscian framework, the focus is not macro-level analysis, but rather an assessment of one particular institution: the institution of investment protection. This section provides a more precise definition of an institution. It describes the sources of the norms and rules that form the basis of the institution of investment protection and clarifies the nature of this institution as a hybrid of public and private authority.

3.2.1 One Institution or Many?

As Duffield notes, the term institution “is frequently used to refer to distinctly different empirical phenomena, such as intergovernmental organizations ... inter-

⁶⁰Cutler 1999, at 77.

⁶¹Adler and Bernstein 2005, at 310.

⁶²Cox 1993, at 39.

⁶³Levy and Newell 2005, at 54.

⁶⁴*Ibid* at 51; Egan 2003, at 77; Cox 1993, at 45.

national regimes, and sets of norms.”⁶⁵ In this study, the concept of an institution is used to group together a variety of norms and rules that interact to provide protection to foreign investors. While each IIA, contract, or set of arbitral rules could individually be classified as an institution, it is the collection of norms and rules that compose these agreements that is of interest here. While it is true that treating these norms and rules collectively risks ignoring potentially significant discrepancies between various agreements (see further the discussion of BITs in Section 3.2.2), it allows for cross-case comparison and a more comprehensive treatment of issues that transcend one individual agreement.

The definition adopted in this study builds on Duffield’s conceptualization of international institutions as “relatively stable sets of related constitutive, regulative, and procedural norms and rules that pertain to the international system, the actors in the system (including states as well as non-state entities), and their activities.”⁶⁶ For further explanation, norms can be defined as “socially shared expectations, understandings, or standards of appropriate behaviour for actors with a given identity.”⁶⁷ Norms are implicitly consensual, and cannot be imposed, but carry a sense of obligation. Norms can vary in strength and exert differing degrees of influence. While norms are intersubjective, rules are formal. However, rules may exhibit differing degrees of formality or formalization. Young suggests that rules are “well-defined guides to action or standards setting forth actions that members [of an institution] are expected to perform (or to refrain from performing) under appropriate circumstances.”⁶⁸ Constitutive norms and rules endow actors with significant roles and rights and “determine their underlying identities, interests, and preferences.”⁶⁹ Regulative norms and rules order and constrain behaviour: they can be prescriptive (requiring or obligating actors to behave in certain ways), or they may proscribe, prohibit or forbid various actions, or they may be permissive (allowing actors to engage in certain actions).⁷⁰ Finally, procedural

⁶⁵Duffield 2007, at 1.

⁶⁶*Ibid.*, at 2.

⁶⁷*Ibid.*, at 6.

⁶⁸Young 1989, at 16.

⁶⁹Duffield 2007, at 7 and 13.

⁷⁰*Ibid.*, at 14.

norms and rules govern the interactions of actors within an institution.⁷¹

This definition explicitly acknowledges a role for non-state actors in institutions and the possibility of *private* or *public-private* institutions (see Section 3.2.3). Furthermore, it recognizes the constitutive function of institutions that is emphasized by constructivist and critical scholars. However, as it is a definition of international institutions, it focuses explicitly on norms and rules that pertain to the *international system*. As such, it reifies an international-domestic divide which, it is argued here, is inappropriate in a study of investor-state interaction.

Instead, it is suggested that the institution of investment protection is *transnational* in nature. Processes within this institution transcend territorial boundaries, but foreign investors operate within the bounds of the state. It then follows that the transnational institution of investment protection *operates simultaneously at the international, national, and subnational levels, and is composed of a relatively stable set of related constitutive, regulative, and procedural norms and rules that pertain to the protection of foreign investors and their investments within host states*.

3.2.2 Sources of Norms and Rules

Some norms and rules are universal, and enshrined in customary international law, while others only exist in specific IIAs or state contracts. Furthermore, several different sets of procedural norms and rules of arbitration may be applied to a given dispute, depending on stipulations in an IIA or state contract, and in some cases, the choice of the investor.

Customary International Law

Customary international law consists of norms and rules that are deduced from the behaviour of states. In order for law to be customary, a substantial number of states must have acted consistently as if they believed that they were required by law to behave in a given way (*opinio juris*).⁷² Customary international law

⁷¹*Ibid.*, at 7 and 14.

⁷²Sornarajah 2004a, at 89.

is important because it may influence the interpretation and application of treaty provisions, and in some cases modify their content.⁷³

Defining norms of customary international law in any area is generally a difficult task. Byers notes that custom arises out of “frequently ambiguous combinations of behavioural regularity and expressed or inferred acknowledgments of legality.”⁷⁴ However, it is especially difficult to define in the area of investment protection where opinions on what constitutes custom are particularly divisive. Some authors would argue that the General Assembly resolutions on permanent sovereignty over natural resources and CERDS (see Section 2.1.2) should be considered a part of customary international law.⁷⁵ However, Paasivirta argues that, “the Charter, whilst in many respects reflecting the present customary law, has not gained full recognition as regards its treatment of foreign investment.”⁷⁶ Others have suggested that the vast number of BITs have established certain norms of investment protection as custom, despite the fact that developing countries have traditionally rejected them in other fora.⁷⁷ In opposition to this view, Sornarajah argues that BITs are not consistent enough to constitute custom; they vary considerably depending on which countries are involved in the negotiations, as well as the time at which a treaty was drafted.⁷⁸

It can be concluded that the content of customary international law in the area of investment protection is highly contested and varies not only by observer, but also according to changes in the ebb and flow of prevailing international political and economic forces.⁷⁹

International Investment Agreements

As of the end of 2005, there were an estimated 2,500 BITs, more than 232 regional trade agreements and economic cooperation agreements containing investment

⁷³Byers 1999, at 4.

⁷⁴*Ibid.*, at 3.

⁷⁵Sornarajah 2004a, at 90-1.

⁷⁶Paasivirta 1989, at 339.

⁷⁷Otto and Cordes 2002, at V-32.

⁷⁸Sornarajah 2003, at 181.

⁷⁹Dattu 2000, at 280.

provisions,⁸⁰ and five WTO Agreements covering foreign investment-related issues.⁸¹ IIAs generally include the same basic set of provisions, but there are often textual variations which could result in different interpretations of the same general obligations under different agreements.⁸² IIAs vary based on the countries involved, their relative bargaining strengths, and the time at which a treaty was negotiated; as Sornarajah notes “the treaties made when the sway of economic liberalism was high would tend to include rules favoring more absolute forms of investment protection than treaties made at the time when different ideologies were competing with each other.”⁸³

The implicit purpose of an IIA for capital-importing states is to attract foreign investment that will contribute to development. However, this purpose is hardly ever made explicit in the text of an IIA.⁸⁴ The majority of IIAs limit the purpose of the agreement to the ‘promotion and protection’ of investment, and as Newcombe notes, “promotion is largely the assumed byproduct of protection.”⁸⁵ It is investment protection that is the key interest of developed capital-exporting economies.⁸⁶

Many developed countries have taken up the practice of producing what is called a ‘model’ or ‘prototype’ BIT, a template used in negotiations.⁸⁷ Actual BITs tend to follow these models quite closely, with only minor changes. While countries each develop their own model, there are two broad categories that these models generally fit into: European, and North American.⁸⁸ The main differences

⁸⁰ UNCTAD 2006a.

⁸¹ The Agreement on Trade Related Investment Measures (TRIMs); the Agreement on Trade Related Intellectual Property Rights (TRIPs); the General Agreement on Trade in Services (GATS); the Agreement on Subsidies and Countervailing Measures (ASCM); and the Agreement on Government Procurement (GPA). This study does not explore the provisions of the WTO agreements in any detail.

⁸² Houde and Yannaca-Small 2004, at 3.

⁸³ Sornarajah 2003, at 181.

⁸⁴ García-Bolívar 2005, at 760.

⁸⁵ Newcombe 2007a, 373.

⁸⁶ Van Harten 2007a, at 179, points out that these countries are under competitive pressure to protect their own investors in order to avert their flight to other capital-exporting states offering better protection.

⁸⁷ The template may also be used in the drafting of investment chapters in FTAs.

⁸⁸ Houde and Yannaca-Small 2004, at 3; Brewer and Young 1998, at 76.

between the two types are that North American IIAs cover the pre-establishment phase and include provisions on performance requirements (see Section 4.1.4), whereas European IIAs generally do not.⁸⁹

State Contracts

The term ‘state contracts’ refers to contracts between governments and foreign nationals, including loan agreements, contracts for supplies and services, contracts for employment, agreements for the construction or operation of transport or telephone systems, and agreements conferring rights to exploit natural resources.⁹⁰ It is the latter form of state contract that is particularly relevant for the purposes of the present study.

In most developed countries, rights to access natural resources, such as minerals and oil, are based only on law and regulation; however, developing countries have relied far more on state contracts. State contracts that were drawn up in colonial times are generally referred to as ‘concession agreements’. These agreements gave investors nearly limitless rights over vast areas of land for long periods of time, while imposing few obligations on them.⁹¹ During this period, companies possessed significant bargaining power as they had the support of their home states. Following decolonization, the bargaining power shifted to newly independent governments, and many contracts were renegotiated or investments were nationalized.⁹² The types of state contracts that were negotiated in this period were very different from traditional concessions. Referred to as ‘economic development agreements’, they were far more focused on the goals of the state in promoting development.⁹³ This generation of contracts took on new forms such as joint venture agreements, production-sharing agreements, service contracts, contracts of work, and management contracts.⁹⁴ In the modern period, with the increased

⁸⁹*Ibid.*

⁹⁰UNCTAD 2004b, at 135.

⁹¹Peter 1995, at 328.

⁹²See Kolo and Wälde 2000 for examples of contract renegotiations in the mineral sector during this period.

⁹³Otto and Cordes 2002, at I-42.

⁹⁴Maniruzzaman 1992, at 162.

competition between states for foreign investment, the bargaining power has arguably begun to shift back to favour TNCs. As a result, the newest generation of state contracts are chiefly concerned with investment promotion and protection. While they still contain some development provisions, they are mainly ones that impose minimal economic cost to investors.⁹⁵

Countries may negotiate *ad hoc* agreements with investors, which will be unique, or provide model agreements to establish the same conditions for several different projects or some hybrid of the two (where model agreements are provided but more specific terms can be negotiated).⁹⁶ As state contracts are generally confidential documents, at least for a given period of time (usually until after the project has terminated), model agreements obviously provide more transparency and opportunity for public scrutiny and thus reduce the possibilities for corruption in the negotiation process.⁹⁷

State contracts rarely endure for fifty years or more as was possible in colonial times, but they are still long-term in nature. For example, a thirty-year contract with renewal clauses would not be uncommon. One could argue that the long duration of state contracts is justified by the high costs and high risks that investors face in the extractive industries. Nevertheless, it should also be recognized that this aspect of contracts may cause problems for the host state, as international and domestic political circumstances, government priorities, and indeed governments themselves, change over such periods of time.⁹⁸

Arbitral Rules

A state-to-state dispute settlement mechanism has always been present in the large majority of IIAs. Arbitration provides an option beyond diplomatic negotiations, but formal state-to-state investment disputes tend to be quite rare. In the 1960s, a second type of dispute settlement mechanism emerged which allowed for ar-

⁹⁵ Otto and Cordes 2002, at IV-18.

⁹⁶ Otto 1999, at 30.

⁹⁷ That having been said, one of the most widely recognized examples of a successful model agreement program is that of the contract of work (CoW) system in Indonesia, which operated under the New Order regime and has been associated with graft. See further discussion of CoWs in Section 6.1.1.

⁹⁸ Peter 1995, at 14.

bitration directly between an investor and the host state. Investor-state dispute settlement mechanisms are now standard features of IIAs and state contracts.

An international ‘investment court’ has not been established and, as there is no broad multilateral agreement on investment, nothing comparable to the WTO Dispute Settlement Understanding has been set up. Instead, BITs and other IIAs rely on ‘one-off’ tribunals that follow the procedures of various sets of arbitral rules established externally to IIAs.

Investor-state arbitration can be supervised by an administrative body (institutional arbitration)⁹⁹ or can be unsupervised (*ad hoc* arbitration). The supervising body may assist in appointing arbitrators, determining the place of arbitration, determining costs and arbitrator fees, and so forth, and will itself charge a fee for the performance of these functions.

The most important supervisory body referred to in IIAs and state contracts is the International Centre for the Settlement of Investment Disputes (ICSID), which was established in 1966, when the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) came into force. More than 1,500 BITs provide for ICSID arbitration, as do important regional agreements such as the NAFTA.¹⁰⁰ Ratifications of the ICSID Convention rose gradually in the 1980s and accelerated in the 1990s following the accession of the major developing countries and former communist countries.¹⁰¹ As of November 2007, 155 states had signed the Convention, and 143 had ratified it.¹⁰² In order for a dispute to qualify for ICSID arbitration, it must be between a Contracting State and a national of another Contracting State. However, if one of the parties does not meet these criteria, then the Additional Facility, developed in 1978, may be utilized. The ICSID Rules and Additional Facility Rules are periodically revised; the most recent versions came into force in April 2006.¹⁰³ Some

⁹⁹While this is the common terminology employed in the literature, it is not used in this study in order to avoid confusion with institutional theory and the notion of the institution of investment protection.

¹⁰⁰“Canada: ICSID At A Crossroads,” *Mondaq*, 27 September 2006, <http://www.mondaq.com>.

¹⁰¹Van Harten 2007a, at 27.

¹⁰²This number is actually lower than that reported in May 2007: in the intervening period, Bolivia withdrew from the Convention. See further Section 7.4.3.

¹⁰³“Rules of Procedure for Arbitration Proceedings (Arbitration Rules),” *ICSID Convention, Regula-*

of the changes that were made in the latest update to the rules are discussed in Section 7.1.3.

Unlike other supervisory bodies, ICSID was designed expressly for the purpose of handling investor-state arbitrations and does not handle disputes between firms. The Centre is a part of the World Bank Group and is located in Washington, D.C. It is made up of a Secretariat and an Administrative Council composed of one representative of each Contracting State (usually a finance minister or his or her deputy) and chaired by the President of the World Bank.¹⁰⁴ Although ICSID was established in 1966, the first ICSID arbitral tribunal did not convene until 1972, and the pace of cases brought before the Centre remained slow for decades.¹⁰⁵ It is only in the last five years that the caseload of ICSID has increased sharply. Between 2001 and 2006, the number of disputes filed under ICSID was 150% of the total number of cases filed over the first 35 years that the Centre was in existence.¹⁰⁶

The ICC's International Court of Arbitration is another major supervisory body.¹⁰⁷ In contrast to ICSID, the ICC is a private organization, which refers to itself as "voice of world business."¹⁰⁸ The current Rules of Arbitration of the ICC came into force in 1998.¹⁰⁹

In 1976, the most significant set of *ad hoc* arbitral rules were developed by the United Nations Commission on International Trade Law (UNCITRAL).¹¹⁰ UNCITRAL was established by the UN General Assembly in 1966 and was given the general mandate to further the progressive harmonization and unification of the law of international trade.¹¹¹ An integral part of the Commission's work is the

tions and Rules, April 2006, <http://icsid.worldbank.org>.

¹⁰⁴Reed *et al.* 2004, at 5.

¹⁰⁵Egli 2007, at 1063.

¹⁰⁶Rowly 2006.

¹⁰⁷Other supervisory institutions include the Stockholm Chamber of Commerce (SCC), the American Arbitration Association (AAA), and the London Court of International Arbitration (LCIA).

¹⁰⁸"What is ICC?" *ICC website*, <http://www.iccwbo.org/id93/index.html>, accessed 4 January 2008.

¹⁰⁹ICC Rules of Arbitration, 1 January 1998, <http://www.iccwbo.org/court/arbitration/id4199/index.html>.

¹¹⁰UNCITRAL Arbitration Rules, 28 April 1976, *Report of the United Nations Commission on International Trade Law on the Work of its Ninth Session*, UN Doc. A/31/17 (1976), reproduced in 15 *ILM* (1976), at 701.

¹¹¹"Origin, Mandate and Composition of UNCITRAL," *UNCITRAL website*, <http://www.uncitral.org>,

promotion of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958 ‘New York Convention’), which is crucial to the enforcement of awards rendered under UNCITRAL and other rules (see Section 4.2.2).¹¹² At the time of writing, discussions were taking place on a revision of the UNCITRAL Rules for the first time in their history (see Section 7.1.4).

3.2.3 Public and Private Authority

Weintraub points out that the concepts of ‘public’ and ‘private’ mean very different things to different people, and therefore “any discussion of public and private should begin by recognizing, and trying to clarify, the multiple and ambiguous character of its subject matter.”¹¹³ In this study, the distinction between private and public is meant in the sense of the individual versus the collective.¹¹⁴ This distinction is used to differentiate between *state* and *non-state* actors, but also between the *public* and *private* acts of a state (i.e. acts that affect or do not affect the *public* interest).

Scholars have observed that non-state actors are increasingly taking on new and significant roles in the development, implementation, and enforcement of international rules. New forms of private and hybrid (public-private) governance are emerging in a multitude of issue areas.¹¹⁵ Examples include reporting schemes (e.g. the Global Reporting Initiative), certification and labeling schemes (e.g. the Forest Stewardship Council), sets of voluntary principles (e.g. the ICC Business Charter for Sustainable Development), and standards regimes (e.g. the ISO).¹¹⁶

Cutler *et al.* define a ‘private regime’ as “an integrated complex of formal and informal institutions that is a source of governance for an economic issue area as a whole.”¹¹⁷ Falkner presents a broader notion of ‘private governance’:

accessed 4 January 2008.

¹¹²The New York Convention had 142 Parties as of 1 January 2008. The full text of the Convention and its membership status is found on the *UNCITRAL website*, http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html.

¹¹³Weintraub 1997, at 3.

¹¹⁴*Ibid.*, at 5.

¹¹⁵Hall and Biersteker 2002; Cutler *et al.* 1999.

¹¹⁶Pattberg 2007; Clapp 2005; Hall and Biersteker 2002; Cutler *et al.* 1999.

¹¹⁷Cutler *et al.* 1999, at 13.

‘Private governance’ emerges at the global level where the interactions among private actors, or between private actors on the one hand and civil society and state actors on the other, give rise to institutional arrangements that structure and direct actors’ behavior in an issue-specific area. These structuring effects resemble the ‘public’ governing functions of states and inter-governmental institutions, and for this reason the notion of governance, and indeed authority, has been applied to private actors.¹¹⁸

It may not be immediately apparent how the area of investment law fits in to this debate, given that IIAs are intergovernmental (i.e. public) agreements. However, when one looks at the broader architecture of investment protection, which includes state contracts and arbitral rules that have been developed by non-state organizations (e.g. the ICC) with the original intention of governing purely private disputes, it is clear that the line between public and private has been blurred. The arbitration process is a particularly grey area. It brings together public and private rules, state and non-state actors, and vests authority in private actors (arbitrators) in a selection process that is not controlled by states.¹¹⁹

The legal literature emphasizes that arbitrators only ‘interpret’ the rules that have been laid out by states. However, Stone Sweet suggests that arbitration is more accurately described as a form of *governance*.¹²⁰ First, by resolving a dispute, the arbitrator “makes rules that are concrete, particular, and retrospective.”¹²¹ Second, in providing a justification for the decision, the arbitrator “makes rules of an abstract, general, and prospective nature.”¹²² In the first instance the decisions reflect the particular circumstances of the dispute at hand and determine the resolution of that dispute. In the second instance, the decisions affect the very relationship between the parties to the dispute, causing them to reflect on their own interpretations of what that relationship entailed, and likely affecting the future of the relationship and the occurrence and/or outcome of any future disputes.

In addition to conferring the authority to govern in arbitrators, investor-state

¹¹⁸Falkner 2003, at 72-3.

¹¹⁹The state chooses one arbitrator, the investor a second, and they collectively agree on a third. See further Section 4.2.1.

¹²⁰Stone Sweet 1999, at 147.

¹²¹*Ibid.*, at 156.

¹²²*Ibid.*, at 157.

dispute settlement, by its very nature, elevates foreign investors to a level of recognition in international law and politics not usually afforded to non-state actors. Foreign investors, like all non-state actors, are considered ‘objects’ rather than ‘subjects’ of public international law.¹²³ According to the International Law Association (ILA), investors are not acquiring international legal personality through investment law *per se*, but they “enjoy a measure of international *locus standi*.”¹²⁴ However, as Cutler argues, no matter what terminology is used, “today transnational corporations are significant *de facto* subjects of law.”¹²⁵ The analytical distinction only serves to make corporations ‘invisible’ under international law when it comes to issues of corporate conduct.¹²⁶ Sornarajah points out that, ironically, while IIAs and contracts give investors standing in international law, efforts to create responsibilities on the part of TNCs have been resisted on the grounds of the absence of international legal personality:

The classic ploy has been to recognise that there is a problem as far as accountability is concerned but that the only method by which the matter can be dealt with is through the formulation of non-binding codes containing exhortations to multinational corporations to conform to its prescriptions. The emergence of strong norms has been stunted through countermanding of such efforts by the home states of multinational corporations. The phenomenon that results is that while treaties protecting multinational corporations are increasing, the rules that seek to impose duties on these corporations are aborted.¹²⁷

Elevating private actors to a level playing field with states is generally considered acceptable when states are acting in a *private* capacity. Van Harten explains how states can act under contracts as private parties:

When a legislature expropriates property, leading to a dispute with its private owner, the passage of the legislation is quintessentially a sovereign act and the resulting dispute quite clearly a matter of public law. Alternatively, when the Government contracts with a company to tend the lawn in front

¹²³Horn 2004, at 9.

¹²⁴International Law Association (ILA) 2006, at 5.

¹²⁵Cutler 2003, at 21.

¹²⁶*Ibid.*

¹²⁷Sornarajah 2006b, at 32.

of Parliament, the Government's conclusion of the contract is a commercial act of the State, one that a private party could carry out, and its resolution by arbitration can credibly be positioned within the private domain.¹²⁸

Van Harten admits that in practice it may be difficult to separate the private and public acts of states, but he argues that in two particular situations the distinction is clear. In IIAs the relationship between the state and an investor is one of *regulator* and *regulated*, and therefore any government acts that are challenged in arbitration will be of a public nature. In contrast, state contracts generally reduce states to private actors participating in commercial relationships and do not cover regulatory acts, and as such "arbitration does not usually determine core questions of public law."¹²⁹ However, if a contract contains a 'stabilization clause' it will cover regulation, and the relationship ceases to be private (see Section 4.1.5).

In summary, the institution of investment protection is a hybrid of public and private authority. States make some of the rules, often influenced by the work of international organizations and private actors, while other rules are developed by private organizations. Private actors are delegated the authority to 'interpret' and apply these rules to specific disputes. This constitutive aspect of the institution is particularly significant in light of the broad and vague nature of the regulative rules and norms of investment protection (see Chapter 4). The elevation of foreign investors to *de facto* subjects of international law is also an important constitutive aspect of the institution. Finally, this hybrid institution has implications for *public policy* when it determines the outcome of regulatory disputes that arise under an IIA or a stabilization clause in a contract.

Scholarly inquiry on the issue of private authority in international affairs has focused on two main questions: (i) what does increasing transnational private authority mean for the continuing existence/relevance of public authority (i.e. the state)?; and what does increasing transnational private authority mean in terms of democratic accountability and legitimacy at all levels of governance?¹³⁰ Both of these issues are addressed in this study with specific reference to environmental governance.

¹²⁸ Van Harten 2007b, at 373.

¹²⁹ *Ibid.*, at 25.

¹³⁰ Cutler 2003, at 28; Hall and Biersteker 2002, at 7.

3.3 A Critical Assessment of the Institution of Investment Protection

In this section, it is argued that the discussions of the institution of investment protection in both political and legal scholarship fail to address several crucial issues. There is a need for a *critical* assessment of the institution that is grounded in political theory. Such a critical assessment is developed in this section through the application of neo-Gramscian insights. This assessment frames the remainder of the study.

3.3.1 A Gap in the Literature

There are numerous assessments, many of them critical, of the MAI negotiations in the OECD.¹³¹ However, with the collapse of the MAI, scholarly attention turned to other issues, and in international relations literature the subsequent proliferation of IIAs has been largely neglected. The one exception is the research devoted to analyzing the effectiveness of BITs in attracting flows of FDI, discussed in Section 1.1.1. Legal scholars have addressed a far broader range of topics related to investment protection. However, the majority of legal scholarship is rationally based and uncritical.¹³² States are viewed as utility-maximizers which rationally evaluate the costs and benefits of complying with IIAs. Guzman's analysis of a state compliance with BITs illustrates the rational perspective:

Consider a country that has signed a BIT in which it promises not to expropriate foreign investment. Assume for the purposes of this example that the country makes this promise because doing so increases the flow of foreign direct investment into the country. Even after making the promise, of course, the country could choose to expropriate the local assets of foreign firms. Assume that the available assets have a total value of \$100 million to the country. This potential gain of \$100 million must be weighed against the cost of an expropriation, which includes several components. First, the violating country loses the benefits currently being provided by foreign firms, including tax revenues, technological transfers, employment, and so on. Suppose

¹³¹ See, e.g., Egan 2003.

¹³² Notable exceptions are the work of Prof. Sornarajah and Gus Van Harten.

that this loss amounts to \$40 million. Second, the country is likely to suffer a reputational loss in the eyes of foreign investors. The act of expropriation signals a willingness to seize the assets of foreigners and reduces the attractiveness of the country to potential investors. Assume this translates into a loss of future investment, which the country values at \$40 million. Finally, the country will suffer a loss of reputational capital with respect to other countries. Potential treaty partners will view the country as a less reliable partner and will be less willing to enter into future agreements. Assume that this loss is equivalent to \$30 million.¹³³

In this example, Guzman has not even taken into account the costs of an arbitration and an award against the state. His aim is rather to show that the reputational effect of a BIT is significant in a cost-benefit analysis. He calculates that the total cost of the expropriation for the state is \$110 million, compared with only a \$100 million benefit. Given the net loss of \$10 million, in Guzman's view the state will clearly choose to honour its commitment, and forgo the expropriation.

There are four main problems with this type of cost-benefit approach to investment protection: (i) it assumes that the effects of an institution are intended and anticipated by states; (ii) it assumes that states have perfect knowledge with regard to outcomes; (iii) it assumes that the costs and benefits of a given course of action can be objectively measured; and (iv) it ignores the domestic politics that lead to government decisions.

First, this approach assumes that a state acts with the intention to comply with or to breach its international obligations. In Guzman's example, the government contemplated an intentional expropriation of an investment for material gain. By contrast, investor-state disputes concerning the environment presumably arise *unintentionally*. Young refers to the unintended effects of institutions as 'side effects', and notes that:

In individual cases, the impact of the relevant side effects may equal or even exceed the magnitude of the intended effect attributable to the operation of international regimes, a fact that should give pause to regime enthusiasts who advocate the creation of new institutions as a solution to every problem.¹³⁴

¹³³ Guzman 2002, at 1851-2.

¹³⁴ Young 1994, at 151-2.

Side effects are possibly not even *anticipated* by a government when it negotiates a contract or an IIA. Martin and Simmons argue that it is important to differentiate between unintended and unanticipated effects:

Effects may be anticipated but unintended. For example, it is generally expected that arrangements to lower the rate of inflation will lead to somewhat higher levels of unemployment. Thus, higher unemployment is an anticipated, although unintended, consequence of stringent monetary policies. It is best understood as a price actors are sometimes willing to bear to gain the benefits of low inflation. Such *unintended but anticipated consequences of institutions present little challenge to a rationalist approach*, since they fit neatly into a typical cost-benefit analysis. Genuinely *unanticipated effects, however, present a larger challenge*.¹³⁵

According to Martin and Simmons, unanticipated effects are more likely “in situations that have relatively complex and permutable secondary rules, such as legalized institutions.”¹³⁶ Abbott and Snidal argue that delegation (for example to an arbitral tribunal), “provides the greatest source of unanticipated sovereignty costs.”¹³⁷ In the specific case of the NAFTA, Abbott suggests that Chapter 11 “has been invoked by private investors in circumstances that were not contemplated by NAFTA negotiators” and that disputes have “yielded certain unanticipated results.”¹³⁸ Dhooge argues that the NAFTA’s Chapter 11 has “opened a proverbial Pandora’s Box of unintended and unanticipated consequences for future environmental regulation.”¹³⁹ Comments made by US Senator Kerry in 2002 further support the claim that the legislators who passed the NAFTA did not anticipate the investor-state arbitrations that resulted:

When we passed NAFTA, there wasn’t one word of debate on the subject of the Chapter 11 resolution - not one word. Nobody knew what was going to happen. Nobody knew what the impacts might be.¹⁴⁰

¹³⁵ Martin and Simmons 1998, at 750, emphasis added.

¹³⁶ *Ibid.*

¹³⁷ Abbott and Snidal 2000, at 438.

¹³⁸ Abbott 2000, at 522 and 547.

¹³⁹ Dhooge 2001, at 274.

¹⁴⁰ Qtd. in Kinnear and Hansen 2005, at 104.

Finally, a statement from the Attorney General of Pakistan, Makhdoom Ali Khan, suggests that this is the experience outside of the NAFTA as well; he claims that BITs “are signed without any knowledge of their implications,” and that it is not until “you are hit by the first investor-state arbitration [that] you realize what these words mean.”¹⁴¹

The second problem with the rational cost-benefit approach, is that it also assumes that governments have perfect knowledge with regard to outcomes, that is that they can predict the costs and benefits of all courses of action. This logic is questionable in many circumstances, but particularly so where norms and rules intended to govern behaviour are very *imprecise*. While a direct expropriation, given as an example by Guzman, is likely the most straightforward issue in international investment law, it is nevertheless notoriously difficult for states, investors, and arbitral tribunals to determine when an expropriation is lawful and to agree on the level of compensation that is appropriate. Furthermore, direct expropriation, although a major problem in the past, is now a rarity. Contemporary issues in investment protection predominantly concern regulatory interference with investment. In the case of an *indirect* expropriation (see Section 4.1.3), or other instances where regulation or the actions of courts have affected an investment, the complexities of applying investment law are manifold. Predicting the outcome of a arbitration in such a case is further complicated by a lack of transparency and consistency in arbitral practice, and by the limited number of cases that have been decided to date (see Section 4.3.2 and Chapter 5 in its entirety.).

Thirdly, the rational cost-benefit approach assumes that a concrete value can be placed on the *benefit* of interfering with an investment. In Guzman’s example, the benefit to the state of the direct expropriation was assessed at \$100 million. Again, when one is discussing regulatory interference with an investment rather than an outright taking, such a simple calculation is impossible. For example, how does one quantify the benefit of protecting biodiversity? Economists may have derived many ways of answering this type of question, but it is undeniably a value-laden issue; politics and ideology will very much factor into a government’s assessment.

¹⁴¹“Pakistan Attorney General Advises States to Scrutinize Investment Treaties Carefully,” *Investment Treaty News*, 1 December 2006, <http://www.iisd.org/investment/itn>.

Finally, the approach taken by Guzman and the vast majority of international law scholars ignores the dynamics of domestic politics that lead to a decisions such as whether to expropriate a property. For example, if a government felt that its response to an investor-state conflict would determine the outcome of an upcoming election, it might very well choose a course of action that would otherwise appear ‘irrational’.

As rational approaches dominate legal scholarship, and political scientists have largely ignored the topic, the most substantial critiques of the institution of investment protection have emerged outside of academia. Several NGOs, most of them based in the US or Canada, have done a remarkable job of generating information about, and sound criticisms of, IIAs and specific investor-state disputes.¹⁴² While the work of these NGOs is commendable for its depth and sophistication, it is argued here that there remains a need for an academic account of the institution of investment protection that is grounded in political theory.

3.3.2 Neo-Gramscian Insights

The institution of investment protection is viewed in this study as a key component in the ‘new constitutionalism’.¹⁴³ The institution is aimed at binding states to a version of economic liberalism and ‘locking-in’ regulatory frameworks to ensure predictability for investors.¹⁴⁴ The institution is a product of the dominance of the ideology of disciplinary neoliberalism, but it also serves to further propagate this ideology. In this ideology investment protection is framed in the institution as necessary for the attraction of FDI, which is in turn put forth as an essential requirement for development. As Egan argues, “negotiations to liberalize trade and investment serve the dual role of seeking to free capital from regulation as well as to construct a *common sense understanding of the inevitability and desirability of doing so*.”¹⁴⁵

In addition, disciplinary neoliberalism frames arbitration as neutral and de-

¹⁴²The leader in this field is the International Institute of Sustainable Development (IISD), but also prominent is the Center for International Environmental Law (CIEL).

¹⁴³See also Schneiderman 2000.

¹⁴⁴Schneiderman 2001, at 521.

¹⁴⁵Egan 2003, at 79, emphasis added.

politicized. Arbitrators are viewed not as governors, but as mere interpreters of the law, which itself is viewed as rational and unbiased. However, as Cutler argues, “[w]hile the authority of law clearly rests on the belief that more than the rule of social mores, pure power, or economic efficiency is involved, it is important to recognize the role of human agency in its creation and application.”¹⁴⁶ Picciotto further suggests that, “the interpretation and application of legal rules is not a mechanistic but a flexible process, which allows scope for the overt or covert consideration of social, political, and cultural factors and adaptation to circumstances” and furthermore reminds us that, “legal rules are normative, and hence their interpretation inevitably involves judgments about values.”¹⁴⁷ In domestic courts, these judgments about values are made by individuals that are accountable to the government and thereby the public, but in arbitration, traditional mechanisms of accountability are lacking (see Section 4.3.2). Nevertheless, arbitration is held up to be impartial while national legal systems are made out to be arbitrary. Scheuerman argues that this view is “blatantly ideological.”¹⁴⁸ While it is true that courts and domestic laws may be, on occasion, biased against foreign capital, Scheuerman suggests that foreign investors’ preference for arbitration also reflects their fear that domestic courts are more concerned with the public interest than with corporate profit.¹⁴⁹

The superiority of arbitration over dispute resolution in national courts is promulgated by international organizations, academics and “corporate legal elites imbued with neoliberal ideology.”¹⁵⁰ Because investment law is highly technical and complex, the implications of its application are only understood by a small set of specialists.¹⁵¹ These specialists are trained to defend the independence and neutrality of arbitration and the separation of law and politics.¹⁵² In the area of investment protection, academic commentators may also have a vested interest in upholding this ideology, if they themselves act as arbitrators or the legal repre-

¹⁴⁶Cutler 2001, at 490.

¹⁴⁷Picciotto 2005, at 479-81.

¹⁴⁸Scheuerman 1999, at 8.

¹⁴⁹*Ibid.*

¹⁵⁰Cutler 1999, at 77.

¹⁵¹Cutler 2003, at 5.

¹⁵²*Ibid.*; Shapiro and Stone Sweet 2002, at 6.

sentatives of parties and thereby profit from the system (see Sections 4.2.1 and 4.3.2). Thus, in the institution of investment protection, legal expertise is privileged while opportunities for public participation and democratic accountability are minimized.

Democratic accountability may be further reduced by the exploitation of the institution of investment protection by elites in government that form a part of the transnational historic bloc. For example, Allee and Huth have argued that political leaders “will seek legal dispute settlement in situations where they anticipate sizeable domestic political costs should they attempt to settle a dispute through the making of bilateral, negotiated concessions.”¹⁵³ The authors refer to this as ‘political cover’. Through political cover, a leader can use the existence of an international constraint as a defense for a politically unpalatable position. In a similar vein, Brewster has assessed how international constraints can benefit certain divisions of government, resulting in a shift of power (e.g. from the legislature to the executive) and a change in the results of the domestic political process.¹⁵⁴ Her insights could equally apply to different sectors of government. Each ministry, agency, or even department within a ministry, may have an agenda that is particular to its mandate. Even if all elected officials generally support economic growth and the attraction of foreign investment, they are likely to have different preferences in how investment is admitted and regulated. It is rare that the separate interests of various branches of government are coordinated with one another to ensure the perfect compatibility.¹⁵⁵ State contracts and IIAs are not likely to be negotiated by the ministries/agencies that make the social and environmental policies that are affected by them. These agreements will most likely be the purview of ministries that deal with economics and foreign affairs or specific industries (e.g. mining): these are the “agencies in closest touch with the global economy” and are likely to hold a stronger position in the government hierarchy than environmental ones.¹⁵⁶

Finally, it should be noted that despite the prevalence of IIAs and state contracts throughout the world, not all hegemonic projects in this field have been

¹⁵³ Allee and Huth 2006, at 219.

¹⁵⁴ Brewster 2006, at 283.

¹⁵⁵ Leon and Terry 2006, at 71.

¹⁵⁶ Cox 1997, at 162.

successful.¹⁵⁷ The failure of the MAI and the similar efforts to negotiate multilateral investment rules in the WTO are evidence that such processes can be successfully contested. However, recalling the notion of *transformismo*, one must also question the extent to which potentially counterhegemonic voices have been co-opted. Gill argues that ‘corporate environmentalism’ is a prime example of *transformismo*:

‘sustainable development’ is primarily defined in public policy as compatible with market forces and freedom of enterprise. When the global environmental movement was perceived as a real threat to corporate interests, companies changed track from suggesting the environmentalists were either crackpots or misguided to accepting a real problem existed and compromise was necessary. Of course a compromise acceptable to capital was not one that would fundamentally challenge the dominant patterns of accumulation partly through strategies of transformative resistance.¹⁵⁸

One need look no further than the WSSD Declaration and Plan of Implementation (see Section 2.2.3) to see how corporate environmentalism has embraced the notion of promoting investment through the institution of investment protection.

3.3.3 A Plan of Inquiry

It can be recalled from Chapter 1 that the overarching question guiding this study concerns the implications of the protection of foreign investment through international investment agreements and state contracts for environmental governance, particularly in developing countries. This question can now be reformulated as

What are the implications of the *institution of investment protection* for environmental governance, particularly in developing countries?

It has been argued above that in addition to material power (the exit option), foreign investors are given voice as *de facto* subjects of international law through the institution of investment protection. This institution is a part of the new constitutionalism: the politico-legal framework that supports the ideology of disciplinary neoliberalism.

¹⁵⁷Egan 2003, at 87.

¹⁵⁸*Ibid.*

As the new constitutionalism is aimed at ‘locking-in’ regulatory frameworks, it is possible that where environmental regulation conflicts with the principles of market efficiency, consistency and efficiency, states will be disciplined. In the context of investment protection, discipline comes in the form of the requirement to compensate investors. Thus, the first step in understanding the implications of the institution of investment protection for environmental governance is to determine the circumstances under which states will be required to compensate investors. This requires a more detailed examination of the rules and norms of investment protection, which is provided in Chapter 4.

However, understanding the structure of international investment law is only the first step: the agency involved in the application and interpretation of these rules is also critical. From a neo-Gramscian perspective, one would anticipate that arbitrators imbued with neoliberal ideology would interpret the rules and norms of investment protection with a *pro-investor bias*. In order to assess how arbitrators have balanced public and private interests in practice, several environmentally relevant investor-state disputes are analyzed in Chapter 5.

As mentioned in Section 1.3.2, it is argued in this study that the institution of investment protection may also play a role in the outcome of investor-state conflicts that are not resolved through arbitration. This is consistent with neo-Gramscian theory. The ideology of disciplinary neoliberalism heightens state concerns about their competitiveness and may therefore, in turn, condition how states will respond to conflicts with investors. Otto and Cordes note that investor-state disputes may be viewed as administrative or managerial failures that affect the government’s political risk ranking and thereby also the future flows of investment.¹⁵⁹ Thus, it is likely that many states will seek to avoid disputes, even if this means rolling-back, reconfiguring, or failing to develop and enforce their environmental policies (regulatory chill).

However, in a neo-Gramscian perspective, the state is not viewed as unitary. Thus, while some ministries, departments, or levels of government (e.g. regional and local governments) may be legitimately constrained by the institution of investment protection, others may benefit from it. In the event of a threat of arbitration, political leaders may use the threat of arbitration as political cover to

¹⁵⁹ Otto and Cordes 2002, at V-16.

dissipate popular dissent over a decision to settle with an investor. Agencies involved in the negotiation of IIAs and state contracts may use their knowledge of the institution of investment protection to support investors and to bolster their own position in the government hierarchy. Savvy foreign investors can strategically exploit these domestic divides by targeting their lobbying efforts at specific ministries, departments and agencies, which are most likely to support them.¹⁶⁰ Through an analysis of second-order outcomes, Chapter 6 assesses how domestic politics are affected by the institution of investment protection, and examines the implications for environmental governance.

Finally, in line with neo-Gramscian scholarship, a static notion of international relations must be rejected and the opportunities for change in the institution of investment protection assessed. Those changes that have occurred in recent years and several potential future avenues of institutional development are analyzed in Chapter 7.

3.4 Summary

This chapter has outlined the guiding theoretical approach adopted in this study. It has explained that conventional international relations theories fail to account for the growing importance of both international law and non-state actors, and has argued that neo-Gramscian ideas and concepts can provide insight on these developments.

This chapter has also elucidated the concept of the *transnational institution of investment protection*, which is composed of a relatively stable set of related constitutive, regulative, and procedural norms and rules that pertain to the protection of foreign investors and their investments within host states. The key constitutive functions of the institution of investment protection are that it accords investors with the legal standing to bring a dispute with a state to arbitration, and it endows arbitrators with the authority to govern the resolution of such disputes. The key regulative and procedural rules of investment protection are examined in the next chapter.

¹⁶⁰Leon and Terry 2006, at 71.

The transnational institution of investment protection is a part of the new constitutionalism. The institution serves to lock states in to the ideology of disciplinary neoliberalism, which frames the arbitration process as neutral and depoliticized. Legal expertise is privileged in the institution, while opportunities for public participation and democratic accountability are minimized. Democratic accountability may be further reduced by the exploitation of the institution by elites in government that participate in the transnational historic bloc.

The critical assessment of the institution of investment protection led to the development of a plan of inquiry for the remainder of the study. This plan calls for a more detailed assessment of the structure of investment protection (regulative and procedural norms and rules) and how it relates to environmental governance. It also requires an analysis of the operation of agency in the institution, in particular how arbitrators balance public and private interests. Furthermore, the plan entails an assessment of the role that the institution plays in facilitating the voice of foreign investors, and the implications of threats to arbitrate. Finally, a critical assessment necessitates an evaluation of the opportunities for change within the institution of investment protection, as well as within the broader context of international relations. It is to these issues that the study now turns.

Key Norms and Rules of 4 Investment Protection

In Chapter 3, the institution of investment protection was defined as a relatively stable set of related constitutive, regulative, and procedural norms and rules that pertain to the protection of foreign investors and their investments within host states. It was further noted that the key constitutive functions of the institution of investment protection are that it endows actors with the role and rights of an arbitrator to a dispute and that it accords investors with the legal standing to bring a dispute with a state to arbitration.

This chapter analyzes the key regulative and procedural norms and rules of investment protection that are relevant to the protection of the environment. It first explores in detail the regulative rules of investment protection. It then examines the procedural norms and rules of investment protection (i.e. investment arbitration). In the concluding section, the implications for environmental governance and developing countries are assessed.

4.1 Regulative Norms and Rules

As noted in Chapter 2, regulative norms and rules order and constrain behaviour and they can prescribe, proscribe, prohibit or permit certain actions or activities.

This section discusses the regulative norms and rules of investment protection that are most relevant in investor-state disputes pertaining to environmental protection, namely: national treatment and most-favoured-nation treatment (relative standards of treatment); the international minimum standard of treatment, fair and equitable treatment, and full protection and security (absolute standards of treatment); prohibition of expropriation without compensation; prohibition of performance requirements; stability of host country law; and observance of obligations (umbrella clauses).

4.1.1 Relative Standards of Treatment

Relative standards “define the required treatment to be granted to investment by reference to the treatment accorded to other investment.”¹ The most important relative standards, often found in the same article or paragraph, are national treatment and most-favoured-nation treatment.

National Treatment

National treatment is one of the core provisions of investment protection.² Essentially, it requires that countries not discriminate against foreign investors in favour of domestic ones. The standard of treatment can be defined in two ways: ‘same’ or ‘as favourable as’ treatment; or ‘no less favourable’ treatment. The difference is subtle, but the ‘no less favourable’ formulation, which is the most common in IIAs, leaves open the possibility that investors may be entitled to treatment that is more favourable than that accorded domestic investors, in accordance with international standards.

National treatment provisions may refer to the treatment of only investors, only investments, or as is the case in an increasing number of IIAs, to both investments and investors in order to avoid ambiguity on this issue. For example, the Japan-Sri Lanka BIT states first that:

¹UNCTAD 2007a, at 28.

²Although it is unusual, some IIAs, such as the Association of South-East Asian Nations (ASEAN) Agreement for the Protection and Promotion of Investments and the early BITs signed by China, Norway and Sweden, do not grant national treatment. See UNCTAD 1999c, at 16.

Neither Contracting Party shall within its territory subject *investments* and returns of nationals and companies of the other Contracting Party to treatment *less favourable* than that accorded to investments and returns of nationals and companies of the former Contracting Party or of nationals and companies of any third country.³

It then goes on to state that:

Nationals and companies of either Contracting Party shall within the territory of the other Contracting Party be accorded treatment *no less favourable* than that accorded to nationals and companies of such other Contracting Party or to nationals and companies of any third country in all matters relating to their business activities in connection with their investment.⁴

National treatment can be read narrowly to cover only *de jure* discrimination or broadly to cover also *de facto* discrimination. *De facto* discrimination occurs when a measure not specifically aimed at a foreign investor has the practical effect of less favourable treatment.⁵ *De facto* discrimination focuses on the result of the treatment, and therefore evidence of intent to discriminate on the part of the host state is not necessary.⁶ Similarly, a narrow reading of the standard would require that the treatment reflected a pattern of conduct in the host state's behaviour toward foreign investors as a group, while a broad reading would find a violation even in the case of an isolated event affecting only one investor.⁷

Some IIAs, particularly those signed by Canada and the US, qualify the definition of national treatment by including the provision that it only applies in 'like circumstances' or 'similar circumstances'. While, in theory, this approach offers a narrower scope for comparison than IIAs with no qualifying language, in practice a large scope for interpretation remains.⁸ The issue of 'likeness' has been controversial in the context of the trade regime, where the 'likeness' of products is often compared. In the jurisprudence that has developed under the WTO, likeness has

³Japan and Sri Lanka Agreement Concerning the Promotion and Protection of Investments, 1 March 1982, Colombo, at Art. 3.1, emphasis added.

⁴*Ibid.*, at Art. 3.2, emphasis added.

⁵Van Harten 2007a, at 85; UNCTAD 1999c, at 12.

⁶Weiler 2004, at 171.

⁷Van Harten 2007a, at 85

⁸Gantz 2001, at 677; UNCTAD 1999c, at 34.

been assessed largely on the basis of whether the products can be considered to be substitutes in the marketplace, leaving aside the environmentally relevant question of the processes and production methods utilized in their creation.⁹ It can be argued that ‘like products’ in the trade regime and ‘like circumstances’ in the investment regime are very different and cannot be evaluated in the same manner.¹⁰ In the case of foreign investment, production facilities will operate within the jurisdiction of the state in which measures are taken, and will therefore have a direct impact on that state.¹¹ Nevertheless, investors and investment arbitral tribunals often draw on WTO jurisprudence to support their arguments and decisions.¹²

A further question that has been raised with respect to national treatment is the extent to which the standard applies to subnational authorities.¹³ For example, in a federalist country composed of provinces, would national treatment require that foreign investors be given no less favourable treatment than that accorded to nationals or enterprises from within the province? Or would it only require that they be treated as all other out-of-province nationals are treated? Some IIAs now explicitly refer to such situations, for example, the CAFTA-DR states:

The treatment to be accorded by a Party under paragraphs 1 and 2 means, with respect to a regional level of government, treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that regional level of government to investors, and to investments of investors, of the Party of which it forms a part.¹⁴

This formulation suggests that national treatment in the CAFTA-DR requires only out-of-province treatment.

Finally, IIAs differ on whether national treatment applies only to existing investments and investors or also to the prospective ones. The latter type of treatment is found mainly in agreements negotiated by Canada, the US, and more recently Japan. For example, the Canada-Costa Rica BIT states that:

⁹UNCTAD 2007a, at 37.

¹⁰*Ibid.*

¹¹*Ibid.*

¹²Kurtz 2007, at 311.

¹³UNCTAD 1999c, at 25.

¹⁴CAFTA-DR, at Art. 1003.3.

Each Contracting Party shall permit establishment of a new business enterprise or acquisition of an existing business enterprise or a share of such enterprise by investors or prospective investors of the other Contracting Party on a basis no less favourable than that which, in like circumstances, it permits such acquisition or establishment by ... its own investors or prospective investors.¹⁵

National treatment provisions may be subject to general, subject-specific, and industry specific exceptions.¹⁶

Most-Favoured-Nation Treatment

Most-favoured-nation treatment requires that a government not discriminate between foreign investors from different countries. As with national treatment, the standard can be defined as ‘same’, ‘as favourable as’, or ‘no less favourable’, with the latter choice being the most common. For example, the Sweden-Argentina BIT states that: “Each Contracting Party shall apply to investments in its territory by investors of the other Contracting Party a treatment which is *no less favourable* than that accorded to investments by investors of third States.”¹⁷

As with national treatment, some IIAs qualify most-favoured-nation treatment so that it does not require the host country to treat enterprises in different sectors or in different ‘situations’ or ‘circumstances’ the same, and refer to the treatment of both investments and investors. For example, Article 1103 of the NAFTA states in the first paragraph that

Each Party shall accord to investors of another Party treatment *no less favorable* than that it accords, *in like circumstances*, to investors of any other Party or of a non-Party with respect to the *establishment*, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

¹⁵ Agreement between the Government of Canada and the Government of the Republic of Costa Rica for the Promotion and Protection of Investments, 18 March 1998, San José, at Art. 3.

¹⁶ UNCTAD 1999c, at 43-6. For examples of exceptions see UNCTAD 2007a.

¹⁷ Agreement between the Government of the Kingdom of Sweden and the Government of the Republic of Argentina on the Promotion and Reciprocal Protection of Investments, 22 November 1991, Stockholm, at Art. 3.1, emphasis added.

It repeats this formulation for “investments of investors of another Party” in the second paragraph. Also, as with national treatment, most-favoured-nation treatment may apply only to the post-establishment, or also to pre-establishment, phases of investment.

There has been some controversy over whether most-favoured-nation treatment allows investors to ‘import’ more favourable provisions from other investment agreements signed by the host country. In *Maffezini v. Spain*, the Tribunal decided that the most-favoured-nation clause in the Spain-Argentina BIT could be applied in such a manner as to allow the claimant to have access to dispute resolution provisions in a BIT between Spain and Chile (so-called treaty piggy-backing).¹⁸ The *Maffezini* case prompted the parties to the CAFTA-DR to include a footnote in the 2004 draft text of the agreement, referred to as the ‘Maffezini exclusion’, stating that the Parties did not agree with the arbitral decision in that case. Another possible issue is the importation of pre-establishment rights into BITs that only cover post-establishment rights.¹⁹

There are some exceptions to most-favoured-nation treatment that can be found in IIAs: to exclude treatment provided under a customs union, common market, or free trade area; and also, in some cases, to exclude matters of taxation, government procurement and subsidies.²⁰ For example, the Australia-Philippines BIT states that:

The provisions of this Agreement relative to the grant of treatment not less favourable than that accorded to the investors of any third State shall not be construed as to oblige one Party to extend to investors of the other Party the benefit of any treatment, preference or privilege resulting from:

a. any existing or future customs union, common market, free trade area,

¹⁸ *Emilio Agustín Maffezini v. Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision on Objections to Jurisdiction, 25 January 2000, 16 *ICSID Review* (2001), at 212, <http://icsid.worldbank.org>. Under the Argentina-Spain BIT the investor was required to exhaust domestic remedies before submitting the dispute to international arbitration. This requirement was not present in the Chile-Spain BIT. For further discussion see Singh 2004. See also Vesel 2007, and Egli 2007, who discuss *Maffezini* as well as several other disputes where tribunals have either accepted or rejected the use of most-favoured-nation clauses to import dispute settlement provisions from other treaties.

¹⁹ UNCTAD 2007a, at 25.

²⁰ OECD 2004, at 5.

regional economic organisation, interim agreement or arrangement leading to the formation of a customs union, common market, free trade area or regional economic organisation to which either Party is or may become a member or other arrangement for the facilitation of frontier trade; or

- b. the provisions of a double taxation agreement with a third country.²¹

Agreements may also include specific exceptions to most-favoured-nation treatment.²²

4.1.2 Absolute Standards of Treatment

Absolute standards of treatment are non-contingent: “They establish the treatment to be accorded to the investment without referring to the manner in which other investments are treated.”²³ The main absolute standards are the international minimum standard of treatment, fair and equitable treatment, and full protection and security.

International Minimum Standard of Treatment

The international minimum standard of treatment can essentially be thought of as a ‘floor’, below which the treatment of foreign investors should not fall. In other words, the standard protects investors from unjust treatment that is not discriminatory (i.e. nationals and/or foreigners from other countries are also treated poorly).

As noted in Section 2.1.1, it has long been debated whether or not such a minimum standard exists in customary international law. Defining the precise nature and content of the standard remains quite problematic, as it is rarely laid out explicitly in the texts of agreements. Referring to cases on state responsibility, one could conclude, as Sornarajah does, that the standard potentially relates to three areas: compensation for expropriation; responsibility for destruction or violence

²¹ Agreement between the Government of Australia and the Government of the Republic of the Philippines on the Promotion and Protection of Investments, 25 January 1995, Manila, at Art. 4.3.

²² For examples of exceptions see UNCTAD 2007a.

²³ UNCTAD 2007a, at 28.

by non-state actors; and denial of justice.²⁴ However, as expropriation is dealt with separately in IIAs, and responsibility for destruction or violence is usually covered by reference to ‘full protection and security’ (see below), the only content unique to the minimum standard would be ‘denial of justice’. The principle of denial of justice derives from customary international law and has been interpreted both broadly (to encompass all types of wrongful conduct on the part of state) and narrowly (to only cover instances where an alien is denied access to courts).²⁵ However, Sornarajah argues that tribunals are generally reluctant to find misconduct on the part of state judicial organs except in extreme cases, which leaves little substance of relevance in the standard (although see further discussion below and in Section 6.3.3).

Historically, the test for breach of the minimum standard was based on the findings of the the tribunal in the *Neer Claim*:

the treatment of an alien, in order to constitute an international delinquency should amount to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency.²⁶

More recent tribunals have moved away from a Neer-based analysis, and have sought to interpret the minimum standard as covering a broad area of requirements, discussed further below.

Fair and Equitable Treatment and Full Protection and Security

A further question concerning the minimum standard is its relationship to two other absolute standards - fair and equitable treatment and full protection and security. These two standards generally appear in two different incarnations. In one set of agreements, including those negotiated by the US, UK, France, Japan, and Canada, they are included in the same article or paragraph as the minimum

²⁴Sornarajah 2004a, at 330.

²⁵Yannaca-Small 2004, at 28-9.

²⁶Qtd. in Schrijver 1995, at 164.

standard.²⁷ In a second set of agreements, such as those negotiated by Germany, Switzerland and Sweden, they are independent of the minimum standard.²⁸

For example, NAFTA Article 1105.1 reads: “Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.” On the other hand, the Netherlands-Chile BIT states:

Each Contracting Party shall ensure fair and equitable treatment to the investments of nationals of the other Contracting Party and shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those nationals. Each Contracting Party shall accord to such investments full security and protection.

The Germany-India BIT simply states that, “[e]ach Contracting Party shall accord to investments as well as investors in respect of such investments at all times fair and equitable treatment and full protection and security in its territory.”²⁹

Many BITs that fall into the second category combine fair and equitable treatment with national and most-favoured-nation treatment. For example, the Denmark-Ethiopia BIT states that:

Each Contracting Party shall in its territory accord to investments made by investors of the other Contracting Party fair and equitable treatment which in no case shall be less favourable than that accorded to its own investors or to investors of any third state, whichever is the more favourable from the point of view of the investor.³⁰

Full protection and security appears to be fairly uncontroversial, and is generally accepted to mean that failure to provide protection to an alien threatened with violence creates state responsibility.³¹ Tribunals that have considered claims

²⁷ Dolzer 2005, at 261; Yannaca-Small 2004, at 10.

²⁸ *Ibid.*

²⁹ Agreement between the Federal Republic of Germany and the Republic of India for the Promotion and Protection of Investments, 10 July 1995, Bonn, at Art. 3.2.

³⁰ Agreement between the Federal Democratic Republic of Ethiopia and the Kingdom of Denmark Concerning the Promotion and Reciprocal Protection of Investments, 24 April 2001, Addis Ababa, at Art. 3.1.

³¹ Sornarajah 2004a, at 342.

of violation of full protection and security have generally interpreted the standard as requiring the host state to employ ‘due diligence’ in actively protecting foreign investors from harm.³²

It is far more difficult to pin down a universal definition of fair and equitable treatment. If one interprets fair and equitable treatment as composing a part of the international minimum standard, then the test to determine whether it has been violated is an objective one, which is based on the existing customary international law on state responsibility for injury to aliens as described above.³³ If, on the other hand, one seeks to use a case-by-case test based on the ‘plain meaning’ of the standard, the evaluation is far less objective. An UNCTAD report suggests that, “the concepts ‘fair’ and ‘equitable’ are by themselves inherently subjective, and therefore lacking in precision.”³⁴ It is further noted in another report of the same organization that the fair and equitable treatment standard is “less amenable to a technical specification than rules requiring national treatment and [most-favoured-nation] treatment of foreign investors,” and that an established body of law or existing legal precedents to assist in the evaluation is lacking.³⁵

Following a review of recent arbitral awards, Westcott concluded that “ensuring stability of the business and legal framework is now an established element of fair and equitable treatment.”³⁶ What is particularly required from the state to create a stable environment for business is further expanded on by the ILA, which suggests that “certain elements of an emergent standard of review of administrative action appear to be taking shape” which reflect “contemporary approaches to good governance.”³⁷ In the view of the ILA, fair and equitable treatment requires

³²Robbins 2006, at 427.

³³UNCTAD 2007a, at 29.

³⁴UNCTAD 1999, at 10-11.

³⁵UNCTAD 2007a, at 29; UNCTAD 2004a, at 80.

³⁶Westcott 2007, at 425.

³⁷ILA 2006, at 16. For examples of common definitions of good governance see those developed by: the OECD, <http://www.oecd.org>; the United Nations Development Programme, <http://www.undp.org>; the UN Office of the High Commissioner for Human Rights, <http://www.unhchr.ch>; the Asian Development Bank, <http://www.adb.org>; the Australian Parliament, <http://www.aph.gov.au>; and the Canadian International Development Agency, <http://www.acdi-cida.gc.ca>. See also the Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters, 25 June 1998, Aarhus,

quite significant obligations on the part of the host state:

it is now reasonably well settled that the standard requires a particular approach to governance, on the part of the host country, that is encapsulated in the obligations to act in a consistent manner, free from ambiguity and in total transparency, without arbitrariness and in accordance with the principle of good faith. In addition, investors can expect due process in the handling of their claims and to have the authorities act in a manner that is non-discriminatory and proportionate to the policy aims involved. These will include the need to observe the goal of creating favourable investment conditions and the observance of the legitimate commercial expectations of the investor.³⁸

With regard to the last point, about the observance of an investor's legitimate commercial expectations³⁹, this is an issue that has also emerged in discussions of expropriation (see below). As Coe and Rubins explain:

Under a common view of international investment law, the foreign investor and host State are entitled to have the governmental interference with the investor's enterprise considered in light of the investor's chosen business model, the nature of its enterprise, the regulatory regime in place at the time of investment, and associated expectations. In recent practice, this has sometimes been expressed in terms of the investor's reasonable 'investment-backed expectations' a formula invoked by disputants and now found within certain investment treaties.⁴⁰

An investor's expectations may be based on treaties signed by the host state, national law, administrative licenses or permits, and even brochures and other materials designed to entice foreigners to invest in the state.⁴¹

<http://www.unece.org>, reproduced in 38 *ILM* (1999), at 517.

³⁸ *Ibid.* Yannaca-Small 2004, at 26, identifies similar categories of obligation falling under the fair and equitable treatment standard including: the obligation of vigilance and protection; due process including non-denial of justice and lack of arbitrariness; transparency; and good faith (which could cover transparency and lack of arbitrariness). See also Behrens 2007, at 175, who lists good faith, non-discrimination, lack of arbitrariness, due process, transparency, consistency, and proportionality as the key requirements of fair and equitable treatment.

³⁹ Also commonly referred to as simply 'legitimate' or 'reasonable' expectations, or 'reasonable investment-backed' expectations.

⁴⁰ Coe and Rubins 2005, at 624.

⁴¹ Madalena 2003, at 77.

Finally, a further issue concerns whether the fair and equitable treatment is an overriding obligation, meaning that the failure to provide other standards of treatment, such as national or most-favoured-nation treatment, constitutes a breach of fair and equitable treatment as well.⁴² An UNCTAD report suggests that “although some instances of practice support the notion that the fair and equitable treatment encompasses the other treatment standards in most investment instruments, this is the minority position.”⁴³

4.1.3 Prohibition of Expropriation without Compensation

As noted in Chapter 1, the direct taking of foreign property has historically been one of the most significant risks to foreign investment. Outright takings are now considered rare in most parts of the world, although recent events in Latin America are a reminder that direct expropriations are not completely a thing of the past.⁴⁴ However, with time, the meaning of expropriation has changed. As Lipson points out: “It is important to remember that the social meaning of expropriation is neither intrinsic nor immutable. Its meaning, and that of investment protection, must be continually reestablished.”⁴⁵

At the moment, the debate over expropriation primarily concerns the way it has been reestablished to cover so-called *indirect* expropriation. Indirect expropriation falls short of actual physical taking of property but results in the effective loss of management, use or control, or a significant depreciation of the value of the assets of a foreign investor.⁴⁶ Soloway suggests that “an indirect expropriation can take an infinite number of forms; it can be essentially *any action, omission, or measure* attributable to a government that interferes with the rights flowing from the foreign-owned property to an extent that the property has been functionally expropriated.”⁴⁷

Indirect expropriations have variously been referred to in IIAs by language

⁴²UNCTAD 1999a, at 35.

⁴³*Ibid.*, at 37.

⁴⁴In 2006, Bolivia, Ecuador, and Venezuela made moves to nationalize oil and gas reserves.

⁴⁵Lipson 1985, at 31-2.

⁴⁶UNCTAD 2000b, at 4.

⁴⁷Soloway 2002, at 133, emphasis added.

such as measures having a ‘similar’ or ‘equivalent’ effect to expropriation. For example, the Finland-Brazil BIT states that:

Investments of investors of each Contracting Party shall not be nationalized, expropriated or subjected to *measures having a similar effect* (hereinafter referred to as ‘expropriation’) in the territory of the other Contracting Party ...⁴⁸

In the case of some IIAs, such as the NAFTA, reference is made to measures ‘tantamount’ to expropriation; this language has been particularly contentious in investment arbitration (see Sections 5.2.2, 5.2.4, and 5.3.1).

For further clarity, a distinction can be made between ‘creeping expropriations’ and ‘regulatory takings’. Creeping expropriations involve the slow and incremental encroachment on the ownership rights of a foreign investor, leading to the devaluation of the investment.⁴⁹ Regulatory takings, are defined by UNCTAD as “those takings of property that fall within the police powers of a State, or otherwise arise from State measures like those pertaining to the regulation of the environment, health, morals, culture or economy of a host country.”⁵⁰ The latter form of indirect expropriation is of particular importance in this study.

It is not a simple matter to determine when regulation crosses the invisible line of what is acceptable (i.e. non-compensable) and what is not. Soloway explains the difficulty in demarcating the boundaries of regulatory takings:

If the definition is too expansive, the argument goes, it could impose potentially huge financial obligations on governments, create disincentives to enact health and safety regulations, and introduce multiple distortions and social inefficiencies. On the other hand, a definition that is too restrictive would obliterate a key investment guarantee that protects foreign investors.⁵¹

⁴⁸ Agreement between the Government of the Republic of Finland and the Government of the Federative Republic of Brazil on the Promotion and Protection of Investments, 28 March 1995, Brasilia, at Art. 5.1, emphasis added.

⁴⁹ UNCTAD 2000b, at 11.

⁵⁰ *Ibid.*, at 12.

⁵¹ Soloway 2002, at 31.

The issue of regulatory takings is also not confined purely to international investment law. Some countries, particularly the US, have strong domestic protections against regulatory takings,⁵² and furthermore both the European Court of Human Rights (ECHR) and the European Court of Justice (ECJ) have issued significant decisions on indirect expropriation under Article 1, Protocol 1 of the European Convention for the Protection of Human Rights and Fundamental Freedoms (European Convention).⁵³ However, given the significance of this issue, and the potential implications for states, Byrne argues that the definition of regulatory expropriation should be a matter of international consensus and “[c]onsequently, it should not be assumed that the principles developed by any particular municipal or regional legal systems, for example, the US and the EU, can be automatically applied on a global basis.”⁵⁴ Furthermore, while the jurisprudence in these arenas may have some relevance to an understanding of the international law on expropriation, the standard set in the US Constitution and the European Convention differ significantly from that found in most IIAs.⁵⁵

Another source of potential ‘precedent’ on indirect expropriations is the Iran-United States Claims Tribunal set up to deal with disputes between US investors and the Iranian government following the 1979 revolution. However, as Been and Beauvais point out, these cases dealt “primarily with postrevolutionary actions such as governmental appointment of managers or supervisors of foreign companies, de facto nationalization, and failure to permit the exportation of foreign-owned equipment.” In other words, these cases addressed government actions that are radically different from the type of regulatory takings that may arise in the environmental context.⁵⁶

⁵²The US Constitution contains specific protections against uncompensated takings in the Fifth and Fourteenth Amendments. See: Been and Beauvais 2003; Appleton 2002; Stanley 2001.

⁵³Been and Beauvais 2003, at 56.

⁵⁴Byrne 2000, at 118.

⁵⁵Been and Beauvais 2003, at 56.

⁵⁶*Ibid.*, at 58.

The Effects Test and Police Powers

In establishing whether or not a regulatory taking has occurred, tribunals have tended to adopt one of two basic approaches. Under the first approach, the tribunal focuses solely on the *effect* of the regulation on the investor.⁵⁷ Those ascribing to the second approach will also examine the effect of a measure on an investor, but will further address the *purpose* of the regulation and assess whether it falls under the state's police powers.⁵⁸

As Gudofsky explains, the 'sole effect' or 'effects' test requires a tribunal to "establish a line between when a government's measure goes 'too far' and imposes too great an interference with the use and enjoyment of property."⁵⁹ In evaluating the effect of a measure, tribunals will likely examine both the economic impact and the duration of the measure. While outside of IIA arbitration (e.g., in the ECHR) there is indication that the investment must be rendered valueless or that the economic impact be at least 'severe' or 'substantial' for a measure to qualify as an expropriation, IIA tribunals place a stronger emphasis on the legitimate expectations of the investor.⁶⁰ It can be recalled from the discussion above that investor expectations may also be factored into an evaluation of whether treatment has been fair and equitable. Muse-Fisher suggests that, in the context of regulatory takings, there is a two-part test to determine the reasonable investment-backed expectations of an investor: (i) the tribunal must determine whether the investor had an actual expectation that his property would not be affected by a given regulation when he purchased it; and (ii) if he did have such an expectation, the tribunal must evaluate whether this expectation was reasonable.⁶¹ The US courts have been hesitant to find an investor's expectations reasonable when he is entering a heavily regulated jurisdiction, particularly if newly enacted legislation only builds on the existing framework.⁶² International tribunals have been less consistent in this respect (see Section 5.4). In addition to the severity of the economic impact of

⁵⁷Kunoy 2005, at 471; Fortier and Drymer 2004, at 300.

⁵⁸Newcombe 2007b, at 417; Mann and Soloway 2002.

⁵⁹Gudofsky 2000, at 259-60.

⁶⁰Gutbrod and Hindelang 2006, at 65; Fortier and Drymer 2004, at 307.

⁶¹Muse-Fisher 2007, at 518-9.

⁶²*Ibid.*

a measure, tribunals are also likely to consider its temporal aspect. A measure that is permanent, or of long duration, is more likely to be considered an expropriation than one that is temporary in nature.⁶³ However, the temporal aspect is not rigidly defined, and a tribunal may assess the particular circumstances of a case to determine whether an action continued long enough to constitute an expropriation.⁶⁴

The task is even more complicated for a tribunal that chooses to examine the purpose of a measure in addition to its effects on an investor. The definition and scope of a state's 'police powers' are not agreed upon and it is debated whether they are quite strictly circumscribed to cover only measures necessary for the maintenance of public order or safety, or are broad enough to cover environmental regulation more generally.⁶⁵ Given the difficulty of drawing a 'bright line' between *bona fide* non-compensable regulation and a taking, many commentators and arbitral tribunals suggest that such a determination can only be achieved on a case-by-case basis.⁶⁶

The Legality of Expropriation

If it is determined that a regulatory measure constitutes a taking, then for the purposes of determining its legality it can be treated the same as a direct expropriation.⁶⁷ According to customary international law, and most IIAs, there are three conditions that must be satisfied in order for a taking to be lawful: it must be for public purpose, non-discriminatory, and compensation must be paid to the affected investor. Some BITs and regional agreements also include a fourth condition, referred to as 'due process'. For example, the Japan-Sri Lanka BIT states that

Investments and returns of nationals and companies of either Contracting Party shall not be subjected to expropriation, nationalization, restriction or any other measure the effects of which would be tantamount to expropriation or nationalization, within the territory of the other Contracting Party

⁶³Coe and Rubins 2005, at 620.

⁶⁴Turk 2005, at 64.

⁶⁵See Muse-Fisher 2007; Newcombe 2007; Baughen 2006; Turk 2005.

⁶⁶Fortier and Drymer 2004, at 314.

⁶⁷Reisman and Sloane 2003, at 121.

unless such measures are taken for a public purpose and under due process of law ; are not discriminatory; and, are taken against prompt, adequate and effective compensation.⁶⁸

Public purpose is fairly straightforward and certainly includes the protection of the environment.⁶⁹ However, it is important to stress that if a regulatory measure *is found to be a taking*, fulfillment of the public purpose requirement does not lead to a determination that no compensation is required. All three (or four) conditions must be fulfilled for an expropriation to be legal.⁷⁰

Traditionally, non-discrimination required that any taking should not unreasonably single out a particular person or group of people, such as measures of retaliation or reprisal against another state or a particular racial group.⁷¹ However, increasingly the scope of this requirement has expanded to cover any discriminatory or arbitrary action, or any action that is without legitimate justification, even if specific nationals are not targeted.⁷²

Due process, a concept borrowed from the American legal system, generally requires that the regulation has been made in accordance with host state law, and that affected parties had access to municipal courts to challenge the government action.⁷³

Akinsaya's statement in 1980 that the requirement for, and measurement of, compensation was "the most important, and most controversial, issue of all rules governing expropriation of foreign property," remains accurate today.⁷⁴ There is a long-standing international debate over compensation that generally falls on a North-South divide. As mentioned in Section 2.1.1, capital-exporting states have long advocated the Hull formula as a means to calculate compensation. It states (in

⁶⁸Japan and Sri Lanka Agreement Concerning the Promotion and Protection of Investments, 1 March 1982, Colombo, at Art. 5.2.

⁶⁹It is important to emphasize that 'police powers' and 'public purpose' are different in both scope and form. The former is narrow and acts as an exception to the requirement for compensation, while the latter is broad and acts as a condition for an expropriation to be defined as legal under international law.

⁷⁰Turk 2005, at 69.

⁷¹UNCTAD 2000b, at 13.

⁷²*Ibid.*

⁷³Madalena 2003, at 77.

⁷⁴Akinsanya 1980, at 25.

its various incarnations) that compensation should be prompt, adequate, and effective. In contrast to this, the ‘appropriate compensation’ doctrine often favoured by developing countries suggests a more complex calculation which factors in other considerations, such as the past practices of the investor, the depletion of natural resources or environmental damage that has occurred as a result of the investment, and the economic situation of the country.⁷⁵ Despite the fact that developing countries have historically objected to the Hull formula and have vehemently denied that it represents customary international law, they have signed numerous IIAs that contain obligations that are equally or even more demanding than it.⁷⁶

IIAs may stipulate more specifically the form, timing, and amount of compensation required in the event of an expropriation. In terms of form, IIAs may dictate what currency compensation payments should be made in, as well as stipulating the investor’s right to transfer payments out of the country.⁷⁷ As for timing, it is usually framed in some manner as to indicate that it will be promptly paid following the expropriatory action. Guidance on the determination of the amount of compensation is generally vague, with terms such as ‘fair market value’ or ‘genuine value’ used. For example, the BIT between the US and Bolivia states that

Compensation shall be paid without delay; be equivalent to the fair market value of the investment immediately before the expropriatory action was taken (‘the date of expropriation’); and be fully realizable and freely transferable. The fair market value shall not reflect any change in value occurring because the expropriatory action had become known before the date of expropriation.⁷⁸

There is no single valuation method that binds tribunals, and while investment agreements may provide some general indicators as to what should be considered

⁷⁵UNCTAD 2000b, at 14.

⁷⁶See Guzman 1998, who uses the prisoner’s dilemma to explain why developing countries have accepted the Hull formula for compensation in BITs when they have traditionally rejected it in favour of an appropriate compensation doctrine. See also Bubb and Rose-Ackerman 2007, who offer an alternative explanation.

⁷⁷UNCTAD 2004a, at 71.

⁷⁸Treaty between the Government of the United States of America and the Government of the Republic of Bolivia Concerning the Encouragement and Reciprocal Protection of Investment, 17 April 1998, Santiago, at Art. III.2.

in a calculation of the value of an expropriated property, relatively few provide for specific methods.⁷⁹ The two most common methods used by tribunals are net book value (NBV) and discounted cash flow (DCF).⁸⁰

4.1.4 Prohibition of Performance Requirements

Performance requirements are stipulations, imposed by governments on investors, which require them to meet certain criteria such as the exportation of a certain percentage of production, the purchase of local products and services, or the employment of local labour. The aim of a performance requirement is to protect local entrepreneurs to some extent and to enhance the overall contribution of foreign investment to local development.⁸¹ However, there are divergent views as to the efficacy of performance requirements in these respects.⁸²

Developed capital-exporting countries tend to view performance requirements as trade-distorting (and they have been addressed to some extent in the WTO) and certain countries, particularly Canada and the US, include provisions on the elimination of performance requirements in their BITs and regional agreements. However, when performance requirements are included in an IIA, the article is often accompanied by an exception clause, generally one modelled on GATT Article XX. For example, the NAFTA provision on performance requirements is accompanied by the following text:

Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in paragraph 1(b) or (c) or 3(a) or (b) shall be construed to prevent any Party from adopting or maintaining measures, including environmental measures:

⁷⁹Coe and Rubins 2005, at 629; UNCTAD 2004a, at 73.

⁸⁰NBV is calculated based on the difference between a company's recorded assets and liabilities. DCF is calculated by discounting (based on inflation etc.) the net cash flow (based on the anticipated future income and expenditures) of an investment over its potential lifespan. On the one hand, NBV has been criticized for not reflecting the cash-generating ability of a company, while on the other hand, it has been suggested that DCF is purely speculative and often generates an inflated value. For further discussion see Sabahi 2007, at 564-7.

⁸¹Sornarajah 2004a, at 237.

⁸²UNCTAD 2003, at 2.

- a. necessary to secure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement;
- b. *necessary to protect human, animal or plant life or health; or*
- c. *necessary for the conservation of living or non-living exhaustible natural resources.*⁸³

4.1.5 Stability of Host Country Law

Stabilization clauses are not found in bilateral and regional investment agreements, but rather in state contracts. One of the main difficulties associated with research on stabilization clauses, and state contracts more generally, is a lack of access to information. In many cases, state contracts are negotiated and signed without the involvement of Parliament or the disclosure of the agreement to the public. Thus, while this section draws on some examples of stabilization clauses and agreements in the mineral sector, it is by no means an exhaustive survey.⁸⁴

The Purpose of Stability

As Balasubramanyam clarifies, “it is the stability of policies over time rather than the stability of governments and political regimes which weigh heavily in the FDI decision process of foreign firms.”⁸⁵ As mentioned above, many observers now argue that fair and equitable treatment requires that host states provide a stable environment for investors. However, stabilization clauses are far more explicit in this respect. The purpose of a stabilization clause is “to preserve the law of the host country as it applies to the investment at the time the state contract is concluded” and to ensure “that the future changes to the law of the host country are inapplicable to the foreign investment contract.”⁸⁶ As Faruque illustrates, stability can be said to have both a temporal and an economic dimension:

Stability has a temporal dimension to the extent that it requires the continuity of the contractual relationship towards its successful completion and

⁸³NAFTA, at Art. 1106.6, emphasis added.

⁸⁴A modified version of this section was published in Tienhaara 2008.

⁸⁵Balasubramanyam 1999, at 35.

⁸⁶UNCTAD 2004b, at 3.

the achievement of desired objectives as contemplated by the parties. The economic dimension, which is also regarded as the most important indicator of a stable contract order, implies maintaining the contractual equilibrium perceived by the parties throughout the duration of the contract.⁸⁷

Notably, stabilization clauses and agreements are found almost exclusively in developing and transition economies. Omalu and Zamora suggest that this is because the more a government is viewed by foreign investors as being “volatile and unreliable,” the more the use of stabilization methods will be “desired and therefore in most cases required” by foreign investors.⁸⁸ In general, investors view developing and transition countries as more politically unstable than developed ones. Furthermore, the relative weakness of developing countries in terms of bargaining power, combined with a strong desire to attract investment, makes them accept conditions that developed countries would not consider.⁸⁹

Promises of stability may be either restricted in their application or all inclusive. A comprehensive stabilization clause that freezes the general legislative framework “attempts to insulate completely contractual undertakings from any change in the applicable law of a host state.”⁹⁰ Stabilization clauses of limited scope may refer to one or more specific areas of legislation. Stabilization is often sought in the fiscal area (tax laws/royalties), in labour legislation, in export-import provisions, or in the free transferability of currencies.⁹¹ Environmental regulations could fall under these categories. Therefore, even if a stabilization clause does not explicitly refer to environmental regulation, it could effectively cover it.⁹²

Methods of Achieving Stability

Investment codes and national legislation in developing countries commonly contain provisions for the stability of investment contracts, and some countries even

⁸⁷Faruque 2006a, at 86.

⁸⁸Omalu and Zamora 1998, at 17.

⁸⁹Faruque 2006b, at 323; Wälde and N’Di 1996, at 223.

⁹⁰Faruque 2006b, at 318.

⁹¹*Ibid.*; Peter 1995, at 221.

⁹²Verhoosel 1998, at 456.

have a stability guarantee included in their constitution.⁹³ Although a constitutional guarantee may have some weight, legislative promises of stability are generally considered less enforceable than a contractual clause or a separate stabilization agreement as laws can be modified at the will of the government. Nevertheless, legislative promises may still be taken into consideration by an arbitral tribunal.⁹⁴

One example of a national law that makes specific reference to the stability of environmental regulations is Algeria's Mining Act of 2001.⁹⁵ Article 84 sets out that a mining lease is to be accompanied by a mining agreement, which should be concluded by the state and the investor, and:

The mining agreement, after its effectiveness, can not be modified but by the written consent of parties. This amendment will be formalised by a rider approved by decree on proposal of the Minister in charge of mines. The mining agreement specifies the obligations and rights of the parties in relation with the legal, financial, fiscal, social and environmental conditions applying to exploitation during its term. It guarantees to the mining claim holder the stability of these conditions during the whole term of the claim according to this law provisions.

The Mining Act thus commits the government to stabilize all mining agreements, which may also themselves contain stabilization clauses.

Contractual stabilization clauses⁹⁶ were reported to have diminished in scope and frequency in the 1970s, but they now appear to be re-emerging in even more extensive forms than were previously observed.⁹⁷ According to a recent study, the use of stabilization clauses is widespread across industries and regions of the world.⁹⁸

⁹³Faruque 2006a, at 105.

⁹⁴Wälde and N'Di 1996, at 240.

⁹⁵Mining Act of the People's Democratic Republic of Algeria, Law no. 01-10 2001. For other examples of stability provisions in recently enacted laws see Maniruzzaman 2007.

⁹⁶It should be noted that there is an important distinction to be made between stabilization clauses and 'intangibility clauses'. Intangibility clauses remove administrative interference in the contract (i.e. the government cannot modify or terminate the contract unilaterally), whereas stabilization clauses control legislative interference in the contract. See Montembault 2003.

⁹⁷Wälde and N'Di 1996, at 218.

⁹⁸Shemberg 2008, at vi.

Traditionally, there were three main ways in which stabilization clauses were formulated in investment contracts.⁹⁹ The first option was to prohibit the enactment of any legislation that would adversely affect the investor's rights. This type of clause could even include the prohibition of nationalization. The second type of clause provided that, in the event of an inconsistency between any legislation enacted in the future and the contract, the latter would prevail. This type of clause could also be extended to ensure that any adverse effects of legislation would be avoided, even in the absence of an inconsistency. Finally, the third type of clause incorporated the host country's law and froze it at a specific date, thus ensuring that legislative changes would not apply to the investment. These three formulations have been collectively referred to as stabilization clauses *stricto sensu*.¹⁰⁰ An example of a freezing clause can be found in the 2005 Mineral Development Agreement between Mittal Steel and the Government of Liberia:

... In particular, any modifications that could be made in the future to the Law as in effect on the Effective Date shall not apply to the CONCESSIONAIRE and its Associates without their prior written consent, but the CONCESSIONAIRE and its Associates may at any time elect to be governed by the legal and regulatory provisions resulting from changes made at any time in the Law as in effect on the Effective Date.¹⁰¹

Stabilization clauses *stricto sensu* are still employed in modern agreements. However, new stabilization clauses, which are essentially a hybrid of 'freezing' with re-negotiation, have also emerged. Such clauses aim to restore the economic equilibrium of the contract in the event of legislative change and have thus been termed 'economic equilibrium clauses'. Since this type of clause does not seek to completely prevent the development or application of new legislation to the investment and favours re-negotiation over arbitration (although arbitration is not precluded if the parties cannot come to an agreement), it is more compatible with the notion of state sovereignty and is likely to be preferable to host governments.¹⁰² However, restoring the economic equilibrium of the contract following

⁹⁹Peter 1995, at 215-17.

¹⁰⁰Faruque 2006b, at 319; Montembault 2003, at 600.

¹⁰¹Article XIX, section 9, quoted in Global Witness 2006, at 31.

¹⁰²Sornarajah 2004a, at 408-9; and Faruque 2006b, at 321.

a legislative change may still have significant implications for the state in terms of compensation to be paid or concessions to be made in other areas. Furthermore, determining what the economic impact of the regulation is and, therefore, how the investor should be compensated may be complex, making re-negotiation difficult. An example of an economic equilibrium clause is found in a contract between the State Oil Company of the Azerbaijan Republic (SOCAR) and a consortium of investors:

The rights and interests accruing to Contractor (or its assignees) under this Contract and its Sub-contractors under this Contract shall not be amended, modified or reduced without the prior consent of Contractor. In the event that the Government or other Azerbaijan authority invokes any present or future law, treaty, intergovernmental agreement, decree or administrative order which contravenes the provisions of this Contract or adversely or positively affects the rights or interests of Contractor hereunder, including, but not limited to, any changes in tax legislation, regulations, administrative practice, or jurisdictional changes pertaining to the Contract Area the terms of this Contract shall be adjusted to re-establish the economic equilibrium of the Parties, and if the rights or interests of Contractor have been adversely affected, then SOCAR shall indemnify the Contractor (and its assignees) for any disbenefit, deterioration in economic circumstances, loss or damages that ensue therefrom. SOCAR shall within the full limits of its authority use its reasonable lawful endeavours to ensure that the Government will take appropriate measures to resolve promptly in accordance with the foregoing principles any conflict or anomaly between such treaty, intergovernmental agreement, law, decree or administrative order and this Contract.¹⁰³

It is also possible for a state contract to be stabilized even in the absence of an explicit stabilization clause. The strength of a state contract depends both on the type of legal system in the country and the nature of the act authorizing the

¹⁰³ Article 23.2 of the Agreement on the Joint Development and Production Sharing for the Azeri and Chirag Fields and the Deep Water Portion of the Gunashli Field in the Azerbaijan Sector of the Caspian Sea Among the State Oil Company of the Azerbaijan Republic and Amoco Caspian Sea Petroleum Ltd., BP Exploration (Caspian Sea) Ltd., Delta Nimir Khazar Ltd., Den Norske Stats Oljeselskap a.s., Lukoil Joint Stock Company, McDermott Azerbaijan, Inc., Pennzoil Caspian Corp., Ramco Hazar Energy Ltd., Turkiye Petrolleri A.O., and Unocal Khazar Ltd. <http://subsites.bp.com/caspian/ACG/Eng/agmt1/agmt1.pdf>

agreement.¹⁰⁴ There are three main ways by which resource exploitation contracts are generally approved: by an act of Parliament; by a decree of the executive or the responsible minister; or by the signature of the responsible minister. A state contract enacted by Parliament provides the most protection to investors as it can effectively stabilize it, perhaps even against subsequent parliamentary actions. Indonesia is an example of a country that passes mineral contracts through Parliament (see Section 6.1.1).

Finally, in what appears to be a growing trend, many governments now offer investors the option to negotiate agreements separate from the main contract, to ensure stability. These agreements are variously termed ‘stability agreements’, ‘development agreements’, or ‘(legal) stability contracts’. Many of these agreements only stabilize the fiscal aspects of the investment (that is, taxes and royalties), while others stabilize the entire legal framework or other specific aspects of it. In Chile, stability contracts include stabilization of the legal, regulatory, and policy regime in addition to fiscal and other incentives.¹⁰⁵ In Peru, the legal stability agreements are valid for 10 years and are offered in a wide variety of sectors with variations in the terms of the agreement by sector. According to an UNCTAD report, the mining, power, hydrocarbon, and infrastructure sectors have the most favourable arrangements.¹⁰⁶

Colombia also provides for legal stability contracts but takes a different approach than Chile or Peru. Direct investments in certain sectors (including mining), which exceed about US \$1.2 million, can obtain contractual protection from adverse changes in national legislation.¹⁰⁷ The contract can have a term of 3 to 20 years, subject to negotiation. While in Chile and Peru, stability agreements can only cover a predetermined list of areas and there is no option for negotiation of the scope of the terms, in Colombia the government has adopted a positive list approach, which means that they may agree to stabilize any regulation, unless expressly excluded by law. An UNCTAD report rightly points out that this approach will encourage investors to maximize the regulations that will be covered by the

¹⁰⁴ Barberis 1998, at 41-3.

¹⁰⁵ UNCTAD 2006b, at 26.

¹⁰⁶ UNCTAD and Japan Bank for International Cooperation 2006, at 18.

¹⁰⁷ UNCTAD 2006b, at 25.

contracts.¹⁰⁸ The report also suggests that this approach may foster disputes and that the “scope for future litigation could be immense.”¹⁰⁹

The Validity and Effect of Stabilization Clauses and Agreements

A long and divisive debate in academia about the validity of stabilization clauses has been largely drawn along ideological lines. While it is certainly important to acknowledge this division, one must also examine, from a practical perspective, the effect that a stabilization clause or agreement will have if it is deemed to be valid by an arbitral tribunal.

Three main positions have been taken by legal experts examining the validity of stabilization techniques: the acceptance of stabilization clauses and contracts as being valid; the dismissal of stabilization clauses as being invalid; and the ‘middle ground’ view, which accepts the validity of stabilization clauses but denies them full effect.

Those who uphold the validity of stabilization clauses emphasize the principle of sanctity of contract and argue that if a state can bind itself by a treaty with another state, then it may also bind itself by a contract with a private party.¹¹⁰ Furthermore, they claim that the inclusion of certain clauses in a contract (particularly stabilization and arbitration clauses) has the effect of ‘internationalizing’ the contract (see Section 2.1.2).

Those who deny the validity of stabilization clauses generally focus on the principle of state sovereignty and the succession of laws principle.¹¹¹ They disagree with both the notion that a foreign investment contract can be equated with an inter-state treaty (as foreign investors do not have international legal personality) and the idea that state obligations rest in some ‘external’ system rather than in national law. It has even been suggested by one author that the theory of inter-

¹⁰⁸ *Ibid.*, at 27.

¹⁰⁹ *Ibid.*

¹¹⁰ See Paasivirta 1989.

¹¹¹ Otto and Cordes 2002, at IV-22, explain that the succession of laws principle provides that the “legislative capacity of lawmakers cannot be bound, nor can the executive/public powers of the government be fettered by a contract with a private individual or corporation, i.e. no parliament can bind its successor through a contractual mechanism.”

nationalization of contracts was only developed in order to give validity to stabilization clauses.¹¹² Furthermore, in the case of contracts in the natural resource sector, there is perhaps even more reason to doubt the validity of stabilization clauses, given the importance of the doctrine of permanent sovereignty over natural resources.¹¹³

Despite the seemingly intractable academic debate on this issue, tribunals have frequently affirmed the validity of stabilization clauses.¹¹⁴ Also, notwithstanding the support for the principle of permanent sovereignty over natural resources, states continue to include commitments to stability in their national legislation and their state contracts. Given these realities, the critical issue would appear to be the extent of the effect of a commitment to stability, which is determined by several factors.¹¹⁵ First, the form of the commitment (that is, contractual clause versus national legislation) and its scope (all-inclusive versus restricted) affects the strength of the commitment and determines its application. Second, the applicable law of the contract has an effect. If the contract is governed by national law, then the effect of a stabilization clause may be limited or negated by constitutional constraints, whereas this is not an issue if international law is chosen as the applicable law of the contract.¹¹⁶ However, even in the latter situation a complete guarantee of contractual stability will not exist, as it is recognized in international law that the state has the right to interfere in a contract when its vital interests are at stake.¹¹⁷

If a tribunal finds that a government has breached a promise of stability, what are the likely consequences? The most accepted argument appears to be that while stabilization clauses cannot stop a government from “doing what it pleases,” the investor will be entitled to “comprehensive compensation” in the instance of a

¹¹²Sornarajah 2004a, at 408.

¹¹³*Ibid.*

¹¹⁴Verhoosel 1998, at 456. See also Cotula 2008.

¹¹⁵Much of the discussion on the effect of stabilization clauses has focused on the issue of whether they make nationalization unlawful. This issue will not be discussed in depth in this study. The primary interest here is in legislative change or government interference in a contract rather than all-out nationalization. For an overview of arbitration cases dealing with the issue of nationalization and stabilization, see Begic 2005.

¹¹⁶Faruque 2006b, at 333-4.

¹¹⁷*Ibid.*

breach.¹¹⁸ Comeaux and Kinsella, for example, suggest that:

Generally, arbitrators will not order specific performance of a concession agreement, even if it contains a stabilization clause, out of respect for state sovereignty and an inability to enforce such an award ... Instead a state's violation of a stabilization clause is more likely to affect the amount of damages awarded or the certainty that damages will be awarded.¹¹⁹

The effect of stability commitment on the amount of damages awarded in the case of a breach has been referred to by Wälde and N'Di as a 'stabilization premium', the amount of which should be determined based on the legal weight of the stabilization promise.¹²⁰

In addition to increasing the likelihood of receiving compensation, and potentially affecting the amount of compensation, several authors also suggest that there is a functional value to stabilization clauses since they can act as a 'bargaining chip' for investors in any re-negotiation of the terms of the contract.¹²¹ There is also a potential 'deterrent effect' of the stabilization clause, which means that governments will be discouraged from committing a breach because it would damage the country's reputation with investors and could lead to arbitration before an international tribunal.¹²²

4.1.6 Observance of Obligations

Another area of considerable debate and diverging opinion, not only in academia but also seemingly amongst arbitrators, is the relationship between breach of contract and breach of treaty. As an UNCTAD report reflects "it is generally accepted that not every breach of State contract on the part of the State automatically entails a violation of international law, or a breach of an applicable IIA."¹²³ There are thus independent standards for determining breach of contract and breach of treaty. However, it is possible for government action in relation to an investment

¹¹⁸Peter 1995, at 227.

¹¹⁹Comeaux and Kinsella 1994, at 25.

¹²⁰Wälde and N'Di 1996, at 267.

¹²¹Peter 1995, at 228; Verhoosel 1998, at 456.

¹²²Faruque 2006b, at 335.

¹²³UNCTAD 2004b, at 9.

protected under contract to amount to a breach of treaty, for example, in the case of an expropriation or when a state's actions or omissions amount to a denial of justice.¹²⁴

Where the debate chiefly lies is on the effect of so-called umbrella clauses. Some IIAs, in fact approximately 40% of existing BITs,¹²⁵ contain such provisions, which refer to the 'observance of obligations' undertaken by host states with respect to foreign investors.¹²⁶ For example, the UK-Jamaica BIT states that "each Contracting Party shall observe any obligations it may have entered into with regard to investments of nationals or companies of the other Contracting Party."¹²⁷

Dolzer and Stevens have asserted that umbrella clauses protect an investor's contractual rights against "any interference which might be caused by either a simple breach of contract or by administrative or legislative acts."¹²⁸ Schreuer similarly argues that the purpose of the umbrella clause is to "add extra protection" and to dispense "with the often difficult proof that there has been an indirect expropriation or a violation of the fair and equitable standard under the treaty."¹²⁹ In this view, a violation of a state contract becomes thereby a violation of an applicable IIA.¹³⁰ If this were to be the case, arguably an investor could get around a contractual provision expressly placing disputes within the purview of the domestic courts of the host state. As Cheng notes, the decisions of the 10 tribunals that have considered umbrella clauses are inconsistent, with 5 tribunals taking the view that the umbrella clauses in the respective BITs did not transform the purported contractual breaches of the host state into treaty breaches, and 5 tribunals finding that the umbrella clause could or did transform at least some contractual obligations into treaty obligations (though they differed on the precise scope of

¹²⁴*Ibid.*, at 10; Schreuer 2005, at 298; Foy 2003, at 75-6.

¹²⁵Figure cited in UNCTAD 2007a, at 73.

¹²⁶UNCTAD 2004b, at 19.

¹²⁷Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Jamaica for the Promotion and Protection of Investments, 20 January 1987, Kingston, at Art. 8.

¹²⁸Dolzer and Stevens 1995, at 82.

¹²⁹Schreuer 2005, at 301. See also Wong 2006.

¹³⁰UNCTAD 2004b, at 10.

this transformation).¹³¹

While an investor faced with a choice of treaty rights and contract rights will normally choose to enforce the former,¹³² it may be possible for an investor to pursue both types of claim. If the contract provides for international arbitration, this can lead to duplicative and potentially inconsistent tribunal awards.

4.2 Procedural Norms and Rules

Delegation of dispute resolution to arbitral tribunals is perhaps the most significant aspect of the institution of investment protection. As mentioned in Section 3.2.2, there is no standing investment court, but rather several sets of procedural rules, borrowed from the world of commercial inter-firm disputes, which can be used for the creation and function of one-off arbitral panels. IIAs and contracts may provide the option of choosing amongst several sets of arbitral rules to apply to the dispute. While there are variations among the different sets of rules, some general statements about the set-up and operation of arbitration tribunals can be made. In this study a focus is given to ICSID and UNCITRAL-based arbitration.¹³³

4.2.1 Arbitral Proceedings

According to the ICSID Convention, the host state (a contracting state) or the investor (of a contracting state) may initiate arbitration proceedings, but most IIAs only allow an investor to bring a claim.¹³⁴ IIAs and contracts may require that disputing parties enter into good faith consultations prior to the commencement of arbitration. This ‘cooling off’ period generally lasts 6 months.¹³⁵ Furthermore, there may be a period after which the dispute may no longer be brought to arbi-

¹³¹Cheng 2007, at 1139.

¹³²Cremades and Cairns 2004, at 332.

¹³³According to UNCTAD 2007a, at 110, ICSID and UNCITRAL Rules are the most commonly employed rules in investor-state disputes.

¹³⁴Choi 2007, at 736.

¹³⁵UNCTAD 2007a, at 105.

tration (i.e. a statute of limitations).¹³⁶

Consent to Arbitration and Exhaustion of Local Remedies

Arbitration is a voluntary process. There are a variety of ways in which a state may provide its consent to arbitration and this consent may refer to either a specific investor or a specific dispute or instead to a defined class of unknown investors and future disputes.¹³⁷ In the first instance, consent is generally given in a clause within a state contract. In the second instance, the more general consent can be provided through a clause in an IIA or within national legislation. Consent in this form is referred to as ‘arbitration without privity’,¹³⁸ and is somewhat debated amongst legal experts.¹³⁹ It was only in the 1990s that the inclusion of general consent to arbitration in IIAs became widespread.¹⁴⁰ Van Harten argues that, unlike contractual consent where the state is only providing access to arbitration to specific investors with respect to specific investments, general consent in IIAs:

incorporates within the system a broad class of potential claimants whose identity is unknown to the state at the time of the state’s consent and a wide range of potential disputes arising from any exercise of sovereign authority that affects the assets of a foreign investor.¹⁴¹

The investor, not being party to IIAs, cannot provide such general consent. Investors consent to arbitration by initiating proceedings. The ICSID Convention stipulates that where both parties have consented to the jurisdiction of ICSID, neither party may withdraw its consent unilaterally.¹⁴² Furthermore, consent to ICSID arbitration is at “the exclusion of any other remedy” unless otherwise stated

¹³⁶For example, in the NAFTA, Art. 1116.2 stipulates that a claim under Chapter 11 cannot be made “if more than three years have elapsed from the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage.”

¹³⁷Reed *et al.* 2004, at 7.

¹³⁸Paulsson 1995.

¹³⁹Sornarajah 1997.

¹⁴⁰Van Harten 2007a, at 26.

¹⁴¹*Ibid.*, at 63.

¹⁴²ICSID Convention, at Art. 25.1.

in a contract or IIA.¹⁴³

Customary international law requires the exhaustion of local remedies before a foreign investor's claim may be brought before an international tribunal, but holds that a domestic court's decision is not *res judicata*¹⁴⁴ for a subsequent international tribunal. Dodge summarizes the system well: "It gives the foreign investor two 'bites at the apple' but requires it to take the domestic bite first."¹⁴⁵ However, as noted in Section 2.1.3, the local remedies rule can be waived by international agreement. The ICSID Convention states that: "A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention."¹⁴⁶ Nevertheless, in contrast with other forms of international legal remedies, IIAs rarely require that foreign investors first exhaust domestic legal remedies before proceeding to international arbitration.¹⁴⁷ As Horn points out, exhaustion of local remedies clauses "are not very appreciated by investors who look for ways to immediately commence arbitration procedures."¹⁴⁸

The issue of domestic versus international remedies can become particularly complex when an investor is pursuing both contract claims and treaty claims in relation to the same dispute. Some IIAs have so-called fork in the road provisions, which stipulate that if the investor submits a dispute before the local courts of the host state or to any other agreed dispute resolution procedure, he forever loses the right to submit the same claims to the international arbitration procedure in the IIA.¹⁴⁹ However, contract and treaty claims have been considered to be distinct by some tribunals.¹⁵⁰ Schreuer explains that the fork in the road clause may not be applicable in some circumstances:

¹⁴³ *Ibid.*, at Art. 26.

¹⁴⁴ A final judgement that is not subject to further appeal.

¹⁴⁵ Dodge 2000, at 360.

¹⁴⁶ ICSID Convention, at Art. 26.

¹⁴⁷ Peterson 2004b, at 3, points out that the European Convention for the Protection of Human Rights and Fundamental Freedoms requires claimants to begin in local courts.

¹⁴⁸ Horn 2004, at 25.

¹⁴⁹ Reed *et al.* 2004, at 58.

¹⁵⁰ See the discussion of *Occidental v. Ecuador* in Blades 2006, at 111.

The loss of access to international arbitration applies only if the same dispute based on the same cause of action has previously been submitted to the domestic judiciaries of the host state. If the dispute before the domestic court concerns a contract claim or an appeal against the decision of a regulatory authority and the dispute before the international tribunal concerns a BIT claim, the fork in the road clause will not apply.¹⁵¹

Another provision, slightly different from the fork in the road, is the ‘no U-turn’ rule found in the NAFTA and some BITs.¹⁵² This type of provision allows investors to abandon domestic court proceedings, before or after a decision is rendered, in favor of submission to arbitration, but prohibits an investor from returning to the domestic courts if it is unsuccessful in arbitration.

Arbitrators

While it is possible for a tribunal to consist of a sole arbitrator, or any uneven number of arbitrators, investment arbitration generally runs on a three-arbitrator model. Under this system, the respondent state appoints one arbitrator, the investor appoints one arbitrator and then the two parties jointly agree on a third, who will act as the ‘president’ of the tribunal.¹⁵³ If the parties cannot agree on the selection of the president, they may opt to have a supervisory body, such as ICSID, make the appointment on their behalf. This is possible even in instances where the tribunal is formed under non-ICSID rules. According to Van Harten, the importance of the power of appointment should not be underestimated: “In tripartite arbitration the decision-making process generally turns on the presiding arbitrator given that the party-appointed arbitrators are more likely to take opposing views and that the president usually drafts the award.”¹⁵⁴

ICSID has a Panel of Arbitrators, from which appointments by the body must be made. However, parties may appoint arbitrators from outside the Panel, as long as they are: “persons of high moral character and recognized competence in the

¹⁵¹Schreuer 2005, at 307.

¹⁵²NAFTA, at Art. 1121.2.

¹⁵³Generally the president can not be a national of either the contracting parties. See UNCTAD 2007a, at 113.

¹⁵⁴Van Harten 2007a, at 169.

fields of law, commerce, industry or finance, who may be relied upon to exercise independent judgment.”¹⁵⁵ It is not only barristers and retired judges that are frequently appointed as arbitrators, but also professors.¹⁵⁶ In fact, there is not even a requirement for arbitrators to be experts in international law. Furthermore, it is entirely possible for an individual to act as a legal representative for a respondent or claimant in one case, and an arbitrator in another.¹⁵⁷

Either party may object to the appointment of an arbitrator or seek to have an arbitrator disqualified if it does not meet the criteria outlined in the ICSID Convention.¹⁵⁸ Decisions on disqualification are made by the other members of the tribunal, or if necessary, by the ICSID Secretariat. There are no criteria for the selection of arbitrators laid out in the UNCITRAL Rules, although an appointment can be challenged on the basis of lack of independence or impartiality.¹⁵⁹

The selection of arbitrators is considered a key decision in winning or losing a case. As Dezalay and Garth note, the attorneys for each side “well understand that the ‘authority’ and ‘expertise’ of arbitrators determine their clout within the tribunal.”¹⁶⁰

Confidentiality

As mentioned above, investor-state arbitration has its origin in private firm-to-firm (commercial) dispute resolution. Commercial arbitration is cloaked in confidentiality to protect business interests, and this artifact has carried over to investment arbitration. Consequently, there are no requirements in IIAs or in any of the *ad hoc* or supervised dispute settlement mechanisms for investors to publicly signal their intention to launch a dispute. The ICSID secretariat does keep a registry of all cases filed under its rules, and this registry is published on the Internet and includes the names of the disputants, the date the case was registered and a short description of the dispute. The registry does not indicate whether the case was

¹⁵⁵ICSID Convention, at Art. 40 and 14.1.

¹⁵⁶Goldhaber 2003.

¹⁵⁷Coe 2006, at 1351-2.

¹⁵⁸ICSID Convention, at Art. 57.

¹⁵⁹UNCITRAL Rules, at Rule 10.1.

¹⁶⁰Dezalay and Garth 1996, at 8-9.

brought in relation to a contract, consent to arbitration under a national law, or to the provisions of a BIT or regional treaty. The other supervisory bodies, such as the ICC, do not have a public register and bodies such as UNCITRAL do not even keep track of arbitrations that make use of their *ad hoc* arbitration rules.

Proceedings of investment disputes are held *in camera* and non-disputant parties will not have access unless the disputant parties consent to open the proceedings.¹⁶¹ There have been some changes in the procedures of arbitration related to confidentiality in recent years which will be discussed further in Section 7.1.

Governing Law and Interpretation

IAs and contracts may or may not stipulate the law that is to govern the dispute (i.e. domestic law, international law, the IIA/contract or some combination). In the absence of an explicit choice of law in the IIA or contract or an agreement between the disputing parties, arbitral rules provide some guidance. The ICSID Rules stipulate that “the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.”¹⁶² The UNCITRAL Rules are slightly broader: “the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.”¹⁶³

The interpretation of the regulative norms and rules of investment protection is generally guided by Articles 31 and 32 of the Vienna Convention on the Law of Treaties.¹⁶⁴ Article 31 states that: “A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”¹⁶⁵ The ‘ordinary meaning’ is only to be disregarded if it can be established that the parties intended that a term have ‘special meaning’.¹⁶⁶ In determining the object and purpose of the treaty, an arbitrator is to look to: the text, including any preambular text and

¹⁶¹ICSID Rules, at Rule 32.2; UNCITRAL Rules, at Rule 25.4.

¹⁶²ICSID Rules, at Rule 42.1.

¹⁶³UNCITRAL Rules, at Rule 33.1.

¹⁶⁴Vienna Convention on the Law of Treaties, 23 May 1969, Vienna.

¹⁶⁵*Ibid.*, at Art. 31.1.

¹⁶⁶*Ibid.*, at Art. 31.4.

annexes; any other agreements made by all the parties and related to the treaty; and any instruments made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.¹⁶⁷ An arbitrator should also consider: any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation; and any relevant rules of international law applicable in the relations between the parties.¹⁶⁸

According to Swan, Article 31 sets out “a narrow interpretive paradigm,” while Article 32 is far more flexible and expansive.¹⁶⁹ Article 32 covers supplementary means of interpretation which can be utilized to confirm the interpretation that resulted from application of Article 31 or to supplement the interpretation in cases where the meaning of the treaty remains “ambiguous or obscure” or where application of Article 31 “leads to a result which is manifestly absurd or unreasonable.” In such cases, arbitrators may look to other sources, such as the preparatory work of the treaty.

4.2.2 Arbitral Awards

In the course of arbitral proceedings a tribunal may issue several awards, for example, on jurisdiction, damages, and costs.

Jurisdiction

There are several aspects that a tribunal must consider in order to determine whether it has jurisdiction over a dispute. The most critical concern whether the investment, the investor, and the government measures fall within the scope of the IIA.

The definition of ‘investment’ has evolved over time; while it was originally more narrowly confined to the ‘tangible’ or physical assets of an investor, it has broadened in both academic discourse and international agreements not only to

¹⁶⁷ *Ibid.*, at Art. 31.2.

¹⁶⁸ *Ibid.*, at Art. 31.3.

¹⁶⁹ Swan 2000, at 163.

include ‘intangible’ assets but also to expand the scope of what these intangible assets could entail. Shares in corporations established by the foreign investor, intellectual property rights, contractual rights, and administrative rights are now among the intangible assets that are included in many IIAs. This expansion of the definition of investment has in effect internationalized aspects of investment that were previously within the control of domestic regulation. Some IIAs limit the scope of protection only to investments that have been approved by the government. However, other agreements focus on measures (laws and regulations) ‘relating to’ investments. In this latter form, “a broad range of regulations in the host country could potentially fall under the scope of application of the [agreement].”¹⁷⁰

In terms of the definition of ‘investor’, most IIAs cover both natural persons and legal entities such as corporations. There are several criteria commonly used (separately or in combination) to determine whether a legal entity qualifies under the *ratione personae* requirement of an agreement such as: place of incorporation; location of seat (i.e. where effective management takes place); and nationality of control or ownership.¹⁷¹ Some agreements extend the meaning of the term ‘investor’ to include entities established in third countries if nationals of a party have a controlling interest in the entity, while other agreements specifically preclude this through a ‘denial of benefits’ clause. Broad and open-ended definitions of ‘investor’ leave open the opportunity for companies to structure investments through a chain of holding companies located in different jurisdictions, which provides them with the option of ‘forum shopping’ or pursuing multiple claims through different IIAs.¹⁷²

It should also be noted that there may be temporal restrictions on the application of an IIA to a dispute. The majority of IIAs do not retroactively apply to

¹⁷⁰UNCTAD 2007a, at 7.

¹⁷¹UNCTAD 2004a, at 111.

¹⁷²Houde and Yannaca Small 2004, at 4. For an example of forum shopping see *Aguas del Tunari, S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3, where the claimant, an American company, set up a shell company in the Netherlands to benefit from the Netherlands-Bolivia BIT. For an example of multiple claims/awards, see *CME Czech Republic B.V. v. Czech Republic*, Final Award and Separate Opinion, 14 March 2003, and *Lauder v. Czech Republic* Partial Award and Separate Opinion, 13 September 2001, and Final Award, 3 September 2001.

disputes that arose prior to the entry into force of the agreement.

Damages

In general, arbitral tribunals appear to be wary of awarding restitution to claimants, and prefer instead to only award monetary damages.¹⁷³ However, restitution is not definitively ruled out.¹⁷⁴ Some agreements, such as the 2004 US Model BIT, may stipulate that the respondent state may pay monetary damages in lieu of restitution.¹⁷⁵ The ICSID Convention also strongly favours monetary relief over restitution.¹⁷⁶

As mentioned above, articles on expropriation often contain references to the requirement for compensation, and may indicate whether it is to be *prompt, adequate, and effective* or only *appropriate*. Some IIAs also provide guidance on valuation. However, often the tribunal is left a significant degree of discretion to determine damages, which may include lost future profits. In general, IIAs and contracts do not stipulate how compensation should be calculated for breaches that fall short of expropriation. According to the ILA, the method of assessing compensation in such cases is different and should be “based on the actual market value of the damaged and lost property, taking into account the realities of the political and economic risks faced by the investor in the host country.”¹⁷⁷

Costs

The ICSID Secretariat charges a fee for the lodging of a request for arbitration (US\$25,000), for any interpretation, revision or annulment of an arbitral award rendered pursuant to the Convention (US\$10,000), for the administration of a dispute (US\$20,000 per year plus out of pocket expenses), and for the appointment of an arbitrator or decisions on the challenge of an arbitrator in arbitrations not con-

¹⁷³Coe and Rubins 2005, at 628.

¹⁷⁴See generally Endicott 2007.

¹⁷⁵Kantor 2004, at 390.

¹⁷⁶ICSID Convention, at Art. 54.1.

¹⁷⁷ILA 2006, at 17.

ducted under the Convention or Additional Facility Rules.¹⁷⁸ ICSID Arbitrators receive reimbursement for any direct expenses reasonably incurred in the course of the arbitration, and unless otherwise agreed between them and the parties, a fee of US\$3,000 per day of meetings or other work performed in connection with the proceedings. The tribunal in an ICSID case is free to determine how the costs of the arbitration, and the legal fees of the parties, should be distributed in the award.¹⁷⁹

The UNCITRAL Rules provide that the arbitral tribunal shall fix the costs of arbitration in its award.¹⁸⁰ There is no ceiling for arbitrator fees under the UNCITRAL Rules, though it is stipulated that they “shall be reasonable in amount, taking into account the amount in dispute, the complexity of the subject-matter, the time spent by the arbitrators and any other relevant circumstances of the case.”¹⁸¹ It is also suggested that the “costs of arbitration shall in principle be borne by the unsuccessful party.”¹⁸² However, the arbitral tribunal may choose to divide the costs, including legal fees, between the parties, taking into account the circumstances of the case.¹⁸³

According to an UNCTAD report, companies have been known to spend up to US\$4 million on lawyers’ and arbitrators’ fees for an investor-state dispute, and countries can expect an average tribunal to cost US\$400,000 or more in addition to the US\$1-2 million in legal fees.¹⁸⁴

Publication of Awards

Once a ruling is made by a tribunal there is no requirement to publish the award. ICSID Rules require the consent of both parties to a dispute before a ruling will be published by the Secretariat (although either party may unilaterally publish it

¹⁷⁸This schedule of fees is effective as of 1 January 2008. The administration fee was previously only US\$10,000 per year.

¹⁷⁹ICSID Convention, at Art. 61.

¹⁸⁰UNCITRAL Rules, at Rule 38.

¹⁸¹*Ibid.*, at Rule 39.

¹⁸²*Ibid.*, at Rule 40.

¹⁸³For further discussion on the allocation of costs and fees see Rubins 2003.

¹⁸⁴UNCTAD 2005b, at 7.

elsewhere), while under UNCITRAL Rules the award may only be published with the consent of both the investor and the state.¹⁸⁵

Challenges and Annulment Procedures

The ICSID Convention excludes appeal and forecloses challenges to awards. The only remedies available to the losing party are interpretation of the scope and meaning of the award, revisions of the award based on discovery of a previously unknown factor of decisive importance, and annulment of the award in a limited number of circumstances.¹⁸⁶ An *ad hoc* committee chosen by the ICSID Secretariat rules on the annulment of an award.

The ICSID annulment procedure is unique and available only for disputes that were brought under ICSID Rules. Awards decided under the ICSID Additional Facility Rules or UNCITRAL Rules can be revised or set aside in the place of arbitration or in courts of the state “under the law of which” the award was made.¹⁸⁷ Some states restrict the scope of court review of arbitral decisions within their territories, in part because tribunals generally seek to avoid siting proceedings in states where the scope for review of awards is broad.¹⁸⁸

Enforcement of Awards

In the view of Van Harten, “the awards of arbitrators are more widely enforceable than any other adjudicative decision in public law.”¹⁸⁹ There are several mechanisms which aid in the enforcement of arbitral awards. Firstly, IIAs often explicitly obligate states to recognize awards, thus allowing investors to seek enforcement in the local courts of the host state.¹⁹⁰ Secondly, where an IIA or

¹⁸⁵ ICSID Rules, at Rule 48.4; UNCITRAL Rules, at Rule 32.5.

¹⁸⁶ The reasons, outlined in Art. 50, 51, and 52 of the ICSID Convention, are: the tribunal was not properly constituted; the tribunal manifestly exceeded its powers; there was corruption on the part of a tribunal member; there was a serious departure from a fundamental rule of procedure; or the award failed to state the reasons on which it was based.

¹⁸⁷ New York Convention, at Art. V.

¹⁸⁸ Gantz 2006, at 52.

¹⁸⁹ Van Harten 2007a, at 5.

¹⁹⁰ *Ibid.*, at 118.

state contract provides for enforcement under the ICSID Convention, an investor can seek enforcement in the domestic courts of any state party to the Convention. Article 54 of the ICSID Convention stipulates that each Contracting State shall recognize an ICSID award as binding and enforce the pecuniary obligations imposed by that award within its territory as if it were a final judgement of a domestic court. As Horn remarks “it is expected that a state that is obliged to recognize an award under Art. 54 will fulfill this commitment as an international obligation, the general consideration being that its international reputation is at stake.”¹⁹¹

ICSID awards have a high execution rate, which some observers hypothesize is a result of the body’s connection to the World Bank.¹⁹² It has been suggested that there is a perception amongst states that failure to enforce an ICSID award could lead to strained relations and a loss of credibility with the Bank.

For awards that cannot be enforced under the ICSID Convention, enforcement can be sought through other agreements, such as the New York Convention. The New York Convention is similar to the ICSID Convention in that it requires courts in Contracting States to enforce arbitral awards. Given its widespread membership and significant role in the enforcement of awards, it is understandable why Wetter has described the New York Convention as “the single most important pillar on which the edifice of international arbitration rests.”¹⁹³

IIAs and state contracts will often stipulate that an arbitration must take place in a country that is party to the New York Convention, as otherwise awards cannot be enforced. Under the New York Convention, the recognition and enforcement of the award may be refused by a court under certain conditions, including when it would be “contrary to the public policy” of the country.¹⁹⁴ However, the public policy exception is typically read quite narrowly by courts.¹⁹⁵

¹⁹¹Horn 2004, at 29.

¹⁹²Franck 2007, at 372; Van Harten 2007a, at 118; Reed *et al.* 2004, at 9.

¹⁹³Wetter qtd. in Van Harten 2007a, at 52.

¹⁹⁴New York Convention, at Art. V.2.

¹⁹⁵Harris 2007, at 10.

Precedent

Awards rendered in investment arbitration are only binding on the parties involved in the dispute: the rulings of tribunals are said to have no *stare decisis*. Hence, tribunals do not have to base their decisions on the decisions of previous tribunals. However, Stone Sweet points out that this is also the case in the trade regime, and yet nevertheless citations to past decisions are common and expected: “Once constructed as a precedent-based discourse about the meaning of GATT rules, panel decisions became a fundamental source of those rules.”¹⁹⁶ Citations to past rulings certainly also occur in investment arbitration, and Cheng argues that “there is an informal, but powerful, system of precedent that constrains arbitrators to account for prior published awards and to stabilize international investment law.”¹⁹⁷

4.3 Implications for Environmental Governance

Having reviewed a number of regulative and procedural norms and rules of investment protection, this section now explores the relevance of these norms and rules to the protection of the environment, particularly in developing countries.

4.3.1 Potential Conflicts with Environmental Policy

The next chapter will deal with actual cases of conflict between the regulative norms and rules of investment protection and environmental policy. However, before delving into the substance of these cases, it is worth reviewing some of the hypothetical conflicts that have been put forth in the literature.

Standards of Treatment

In terms of relative standards of treatment, observers have noted that discrimination (or ‘preferential treatment’, to use a less derogatory term) can, in some

¹⁹⁶Stone Sweet 1999, at 170.

¹⁹⁷Cheng 2007, at 1016. For a quantitative and qualitative assessment of citations in investment tribunal awards, see Commission 2007.

circumstances, be desirable from an environmental perspective.¹⁹⁸ Von Moltke also argues that given the limited resources of environmental authorities and the challenges of implementing environmental law, some degree of “selective enforcement” is inevitable.¹⁹⁹ Criteria such as the nature of the environmental threat, the past history of a company, or public pressure may be of more relevance to an environmental regulator than nationality.²⁰⁰ Examples of preferential measures that could conflict with the national treatment standard include:

- Requiring higher environmental standards and cleaner technologies in foreign-owned operations than in domestic ones;²⁰¹
- Granting special land-use and resource exploitation rights to local communities and indigenous groups, in line with the CBD’s measures to protect customary use;²⁰² and
- Requiring foreign investors to put up bonds or provide insurance guarantees to cover clean up costs or reclamation efforts following the completion of the investment project (not required from domestic investors who cannot exit the jurisdiction before environmental requirements are fulfilled).²⁰³

With regards to most-favoured-nation treatment, Cléménçon rightly points out that:

Effective implementation of environmental agreements may depend on provisions that oblige Member countries to treat companies from non-Member countries (or from Member countries that are in violation of the agreement) differently from companies from complying Member countries.²⁰⁴

It is unclear whether tribunals will be willing to take such issues into account in the assessment of the ‘circumstances’ of different investors. Relative standards, therefore, have the potential to conflict with environmental policies.

¹⁹⁸ Mann and Araya 2002, at 169; Cléménçon 2000, at 208; Downes 1999, at 16.

¹⁹⁹ Von Moltke 2002, at 258.

²⁰⁰ *Ibid.*

²⁰¹ Cléménçon 2000, at 208.

²⁰² Downes 1999, at 16.

²⁰³ Mann and Araya 2002, at 169.

²⁰⁴ Cléménçon 2000, at 205.

However, absolute standards are much more expansive and appear to be more frequently employed in investor claims. Fair and equitable treatment is a particularly problematic standard, especially if a plain meaning approach is applied. According to some, the vagueness surrounding this standard is intentional, in order to give arbitrators a certain amount of discretion.²⁰⁵ Brower suggests that the inclusion of the reference to fair and equitable treatment in Article 1105.1 of the NAFTA “represents the exemplification of an intentionally vague term, designed to give adjudicators a quasi-legislative authority to articulate a variety of rules necessary to achieve the treaty’s object and purpose in particular disputes.”²⁰⁶ Despite, or perhaps because of the imprecise nature of the standard, the ILA has recently argued that fair and equitable treatment is “currently the most important standard, from the perspective of investor protection.”²⁰⁷ Similarly, an UNCTAD report suggests it is the most likely standard to be relied upon by an investor in and arbitral claim.²⁰⁸

According to Freedman, because of the ambiguity of the standard, “some environmentalists have expressed concern that it could be (and perhaps has been) interpreted expansively by an arbitral tribunal to second guess health and environmental regulations.”²⁰⁹ Sornarajah argues that increasingly absolute standards, particularly fair and equitable treatment, are being used by claimants in cases concerning government regulation.²¹⁰ Similarly, Dolzer notes that:

Certainly, the principle of fair and equitable treatment may, in practice, have wide-ranging repercussions for the sovereignty of the host state to determine and apply its administrative law, as it covers all phases of the investments and extends to all areas of domestic law affecting foreign investment. Depending upon how it is interpreted and applied by the tribunals, the principle has the potential to reach further into the traditional *domaine réservé* of the host state than any one of the other rules of the treaties.²¹¹

²⁰⁵Yannaca-Small 2004, at 2.

²⁰⁶Brower 2001a, at 78.

²⁰⁷ILA 2006, at 16.

²⁰⁸UNCTAD 2007a, at 32.

²⁰⁹Freedman 2003, at 96.

²¹⁰Sornarajah 2006a.

²¹¹Dolzer 2005, at 964.

Some governments, particularly in the NAFTA context, appear to have realized that the ambiguity of fair and equitable treatment may in fact give arbitrators too much discretion. As Weiler points out, “[t]he early consensus among NAFTA investors appears to be that ‘fair and equitable treatment’ means anything and everything.”²¹² In the early litigation under the NAFTA, tribunals also had a propensity toward an expansive view, which greatly increased arbitral power to determine whether state acts were in compliance with the agreement.²¹³ In 2001, the NAFTA Free Trade Commission (FTC) issued Notes of Interpretation of Certain Chapter 11 Provisions, rejecting the expansive view that the tribunals had taken by clarifying that fair and equitable treatment and full protection and security do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment.²¹⁴ The US Government has also taken pains to clarify that fair and equitable treatment does not entail anything further than adherence to customary international law in the latest version (2004) of its Model BIT (see Section 7.2.4).

Regulatory Takings

The issue of regulatory takings is a particular point of concern from the perspective of environmental protection and sustainable development. Gutbrod and Hindelang argue that if arbitral tribunals utilize the effects test it could have serious implications for regulation:

determining indirect expropriation only by diminution in property value might reduce national policy space to zero as, governments would then be confronted with claims for compensation any time they change policy, this would limit international law on foreign investment to an insurance policy against bad business decisions.”²¹⁵

It is not possible for a government to predict whether a tribunal will adopt the effects test or a more balanced approach. However, even in the latter case,

²¹²Weiler 2004, at 177.

²¹³CIEL 2003b, at 5.

²¹⁴Notes of Interpretation of Certain Chapter 11 Provisions, NAFTA Free Trade Commission (FTC), 31 July 2001, <http://www.state.gov/documents/organization/38790.pdf>.

²¹⁵Gutbrod and Hindelang 2006, at 64.

there is a broad scope for tribunals to interpret the actions of the government as arbitrary or unnecessary. According to Horn, if an investor claims that an environmental regulation amounts to expropriation, the following questions should be posed: is the environmental regulation proportionate and necessary for a legitimate purpose?; is the law and the application of the law discriminatory?; is there a breach of an agreement or investment treaty or of legitimate, investment-backed expectations?; and does a reasonable adjustment of a regulation to evolving and accepted environmental standards justify certain restrictions on such expectations in the exercise of regulatory powers?²¹⁶ With regards to the final point, it has been suggested that if there has been no substantial change in scientific knowledge or international environmental standards since the time when the state committed to the investment project, a policy change is more likely to be considered an expropriation.²¹⁷

The priority for governments is the ability to establish at the policy development stage whether a measure constitutes a taking or not. However, a stable definition of regulatory takings is unlikely to emerge from investment arbitration in the near future, making such prediction extraordinarily difficult.²¹⁸ Furthermore, it may not only be a government policy which is challenged: Wälde suggests that, “[e]nvironmentally motivated private actions - e.g., a lasting blockade of a mining or energy operation by private environmental groups resulting in the forced closure of the operation - will amount expropriation if the government, even if ex-post, sponsors, supports or formalises them.”²¹⁹

Performance Requirements

Provisions on performance requirements are not as widespread as those on expropriation and standards of treatment, but when they are present in an IIA they may have implications for environmental governance. Freedman notes that prohibitions on performance requirements could affect environmental measures requir-

²¹⁶Horn 2004, at 19.

²¹⁷Fortier and Drymer 2004, at 307; Wälde and Kolo 2001.

²¹⁸Van Harten 2007a, at 93.

²¹⁹Wälde 1998b, at 257.

ing the provision of certain emissions and other environmental information.²²⁰ According to a recent publication of the ILA:

the scope of restrictions on entry and establishment rights may need to be considered further. A particular new issue here may arise in relation to environmental restrictions related to entry, such as, for example, a requirement for an environmental impact assessment of the proposed investment resulting in environmental performance requirements being imposed as a condition of entry.²²¹

Stabilization Clauses

Stabilization clauses in state contracts, which were largely unrecognized by the environmental community until very recently, could have significant implications for the regulation of the environment.²²² More than any other regulative rule of investment protection, stabilization clauses epitomize neo-Gramscian concerns about states being ‘locked-in’ to the new constitutionalism.

The stability of the fiscal regime is generally understood to be the key issue for investors and is the most common area to be stabilized. Stabilization of fiscal matters could also cover market-based environmental measures. While the use of measures, such as environmental levies and taxes, is not yet commonplace in developing countries, there is a global trend toward a greater use of such mechanisms and it can be expected that developing countries will adopt more of these types of instrument in the future.²²³ Stabilization clauses may therefore affect the options available to governments in the development of policy; in other words, the number of tools in the ‘policy toolbox’. If stabilization clauses limit the range of instruments available to regulators, then this may in turn result in a reduction of the effectiveness or efficiency of the policies produced.

Clearly, any stabilization of the general legislative framework applicable to the investment will also cover environmental regulation. However, it is still worth

²²⁰Freedman 2003, at 96.

²²¹ILA 2006, at 14.

²²²However, it is notable that recently several NGOs have begun to investigate the issue. See: Ayine *et al.* 2005; Amnesty International UK 2005.

²²³Verhoosel 1998, at 457.

further questioning whether there is evidence that investors are particularly interested in stabilizing environmental requirements. This depends, in part, on the industry. For example, a poll of investors conducted in 1992 suggests that ‘adverse change in law’ in the area of environmental regulation is a major concern for mineral investors.²²⁴ The “ability to predetermine environmental obligations” ranked tenth out of sixty possible investment decision criteria in the exploration stage and eighth out of sixty criteria in the mining stage. It seems fair to assume that a survey today would find this criterion ranking as high, if not higher. Leading investment law experts have also suggested that after the fiscal regime, environmental regulations were perhaps the most relevant area in which to seek stability.²²⁵

It is not necessarily the ‘strictness’ of the environmental regulation in the host country that concerns investors (as the controversial pollution haven hypothesis would suggest, see Section 1.2.1), but rather uncertainty regarding future changes to the framework.²²⁶ The existing environmental regulatory framework can be factored into a risk-profit assessment before the investment is made, whereas future changes cannot.²²⁷ Investors want predictability, and particularly in developing countries, environmental regulation “is currently one of the most unpredictable factors facing potential investors.”²²⁸ Thus, it is not surprising that environmental regulations are now also explicitly referred to in some stabilization clauses and agreements. For example, in Tanzania, the Mining Act of 1998, which was developed in the context of a World Bank-financed sectoral reform project, permits the Minister of Mines to enter into a ‘development agreement’ with the holder or applicant for a mineral right. According to the Act, the ‘development agreement’ may contain provisions binding on the government:

- a. which guarantee the fiscal stability of a long term mining project, and for that purpose, but not otherwise, make special provision for the payment of royalties, taxes, fees and other fiscal imposts;

²²⁴Otto 1992.

²²⁵Wälde and N’Di 1996, at 230.

²²⁶Otto and Cordes 2002, at IV-49.

²²⁷Bekhechi 2001, at 86; Wälde 2001, at 50.

²²⁸Verhoosel 1998, at 545.

- b. relating to the circumstances or the manner in which the Minister or the Commissioner will exercise any discretion conferred on them by this Act or the Regulations;
- c. *relating to environmental matters, including in respect of matters which are project specific and not covered by regulations of general application, provisions intended to define the scope, and, as may be appropriate in any particular case, limit the extent of obligations or liabilities of the holder of a special mining licence;*
- d. dealing with the settlement of disputes arising out of or relating to the development agreement, the administration of this Act, or the terms and conditions of a special mining licence, including provisions relating to the settlement of any such dispute by international arbitration.²²⁹

This provision goes even further than traditional stabilization clauses, actually permitting the lowering of environmental requirements. According to a Tanzanian NGO, the provision allows the minister to “choose to overlook the requirements for the commission and submission to him of an EIA or an [environmental management plan] for a specific project.”²³⁰ Butler describes this clause as a “legislative loophole,” which “allows some rules to be suspended or modified in favour of private corporate mining interests.”²³¹

The limited nature of contracts and agreements also creates problems in terms of policy coherence. If each investment contract freezes the environmental legislation for one project at a given time, then it is possible for different projects in the same sector to be governed by completely different sets of rules. Furthermore, domestic investors are unlikely to be offered the stability that covers foreign investments, and will therefore also be covered by a separate set of rules:

Stabilization clauses that attempt to immunize the contract from normal operation of the succession of laws principle raise serious practical and legal problems for host countries. If this limit on legislative discretion is effectively secured, ten or even thirty years later the project may operate under a legal regime very different from that governing all other economic activities.

²²⁹ Mining Act of Tanzania, No. 5, 1998, at Art. 10, emphasis added.

²³⁰ Lissu 1999.

²³¹ Butler 2004, at 74-5.

Moreover, different mining projects may operate under different investment terms. From political, economic, administrative and legal perspectives the acceptability of this result is problematic. The concern is likely to be even greater when contracts freeze preferential terms not available to local investors. This would reintroduce a new form of legal and economic enclave and the dangers envisaged by bargaining theorists.²³²

In terms of environmental management, this kind of regulatory incoherence would result in an increased strain on the already limited resources that developing countries have to devote to monitoring and enforcement activities.

Finally, the relationship between stabilization and the implementation of international commitments should be considered. In recent years, NGOs have critiqued the contracts covering several large transnational pipeline projects.²³³ The stabilization clauses in these agreements explicitly cover legislative measures taken by a government to implement an international agreement. Leader summarizes the dilemma that governments face as a result of such contractual commitments:

Poorer states which make such an agreement are thereby put before a difficult choice: either they fully implement into their domestic legal orders the international norms to which they are committed - with no exceptions carved out for the investor - and thereby pay the latter compensation for its lost profit; or else they permit the project to create a hazard to local populations, and find themselves in breach of international standards as a result.²³⁴

He goes on to suggest that it is not difficult to predict what choice the government will make, given the more severe consequences that result when a government “incur[s] the wrath of the international investment community.”²³⁵

4.3.2 The Unaccountable Governance of Disputes

The role of arbitration in the institution of investment protection is particularly significant because the regulative norms and rules are often vague and imprecise.

²³² Otto and Cordes 2002, at V-23.

²³³ In particular, the Baku-Tbilisi-Ceyhan pipeline and the Chad-Cameroon Pipeline. See: Amnesty International UK 2005; 2003; CIEL 2003a.

²³⁴ Leader 2006, at 690.

²³⁵ *Ibid.*

cise. Thus, despite the fact that states are the primary developers of the norms and rules of investment protection, the interpretation of these norms and rules itself involves decision-making and the further development of rules that are not precisely defined at the outset. An acceptance that arbitration is a form of transnational governance, rather than mere interpretation of state-sponsored rules, logically leads one to consider issues of accountability.

Neutrality

As noted in Section 3.3.2, in the dominant ideology of disciplinary neoliberalism, investment arbitration is promoted as a neutral forum, free of the messy politics that influence domestic courts. However, in a critical study, this supposed neutrality must be interrogated.

The international arbitration community is a relatively small and tightly knit group, often referred to as a ‘mafia’ or ‘club.’²³⁶ As Dezalay and Garth argue:

Only a very select and elite group of individuals is able to serve as international arbitrators. They are purportedly selected for their ‘virtue’ - judgment, neutrality, expertise - yet rewarded as if they are participants in international deal-making. In more sociological terms, the *symbolic capital* acquired through a career of public service or scholarship is translated into a substantial cash value in international arbitration.²³⁷

Commission’s data substantiates this claim: he found that in 115 concluded ICSID cases, 43 arbitrators accounted for 49% of appointments, and that in 103 pending ICSID cases, 32 arbitrators accounted for 54% of appointments.²³⁸

This elite group shares “common commercial values”²³⁹ and often uses a “property friendly approach” when making decisions.²⁴⁰ The *culture* of commercial arbitration may be of concern for environmental advocates. As Wälde, an academic and sometimes arbitrator notes:

²³⁶Dezalay and Garth 1996, at 10.

²³⁷*Ibid.*, at 8.

²³⁸Commission 2007, at 138-9.

²³⁹Wälde 1998a.

²⁴⁰Horn 2004, at 19.

the human rights ‘topoi’ get recognized in the like-minded human rights discourse community or environmental ‘topoi’ in the environmental lawyer’s club but it is much harder to get a hard-nosed GATT or [Energy Charter Treaty] arbitral panel to accept what may be fully recognised in another club, not in the international trade lawyers’ community.²⁴¹

The means by which arbitrators are chosen and rewarded for their services also creates the appearance of a biased system. Court judges have no financial stake in the outcome of disputes. Arbitrators, on the other hand, are not only chosen by the parties to the dispute, they are also paid by the hour with no time-limits on proceedings. As Garcia argues, such incentives inevitably favor the party advancing the claim (i.e. the investor), even if unintentionally.²⁴² Van Harten further notes that:

the lack of security of tenure of arbitrators in a one-sided system of state liability, in which only investors bring the claims and only states pay damages for breach of the treaties, makes the adjudicator dependent on prospective claimants and thus biased, in an objective sense, against respondent governments.²⁴³

The fact that individuals can act as both arbitrators and counsel is also problematic, as they may “consciously or unconsciously” make decisions as arbitrators that will further their client’s interests in another case.²⁴⁴ Furthermore, even when such a direct conflict of interest does not exist, it remains the case that a large number of arbitrators work for law firms with corporate clients that have a direct stake in the interpretation of investment provisions.²⁴⁵

The arbitration world is also perceived as a “first world club.”²⁴⁶ Appointing institutions, which have considerable influence over the overall direction of investment arbitration, are in some cases seen as being controlled by powerful developed countries. This is particularly the case with ICSID, given its intimate

²⁴¹Wälde 1998b, at 244.

²⁴²Garcia 2004, at 352.

²⁴³Van Harten 2007a, at 5.

²⁴⁴Buergenthal 2006, at 498.

²⁴⁵Mann 2006, at 76.

²⁴⁶Cutler 2001, at 489.

ties with the World Bank. In any case, a disproportionate number of investor-state arbitrators hail from the US, UK, France, Switzerland and Canada.²⁴⁷ According to Garcia:

the president of the arbitral panel will likely hail from an OECD-member state in continental Europe, and may not be sensitive to or cognizant of the legal, economic, cultural, political, and commercial mores at work in the host state that are the necessary context to any evaluation of investor treatment.²⁴⁸

Furthermore, Wälde suggests that while arbitrators may fear not being re-appointed if they decide against an influential party, decisions against weaker parties (including weaker states) “possibly count less.”²⁴⁹

Otto and Cordes conclude that while in theory arbitration is a neutral forum for the amicable settlement of disputes, this is only possible when the “process and decisional rules are mutually perceived as fair.”²⁵⁰ This is often the case in private contractual disputes, but much less so in disputes involving states, particularly those from the developing world.

Transparency

The lack of transparency in investor-state arbitrations is also a subject of considerable concern. As Blackaby succinctly summarises: “the current opacity occurs at various levels: first, the knowledge of the dispute’s existence; secondly, the access to the process itself and finally the access to the resulting decision.”²⁵¹ Confidentiality makes it impossible for there to be an accurate assessment of how many cases even exist, let alone to know their substantive content. Peterson suggests that there is a “legal iceberg” where an unknown proportion of cases remain hidden from view.²⁵² The lack of transparency may also create an information

²⁴⁷For statistics on frequently appointed arbitrators and their nationalities see Commission 2007, at 138-40.

²⁴⁸Garcia 2004, at 363.

²⁴⁹Wälde 2007, at 51.

²⁵⁰Otto and Cordes 2002, at V-26.

²⁵¹Blackaby 2004.

²⁵²Peterson 2004a, at 129.

imbalance, which puts developing countries at a disadvantage, as Cosbey *et al.* note:

States or investors with the financial resources to hire major international law firms specializing in this area will enjoy greater entre to this disparate body of arbitral decisions through the formal and informal links those firms maintain, than will many developing country counsel relying on scattered and incomplete sources.²⁵³

Blackaby refers to this network of international law firms as the “magic circle” and suggests that it is “not right that [they] should have a wider array of jurisprudence with which to fight their case.”²⁵⁴

Closed proceedings may also upset the balance between the national and lower levels of government within a country. Often it is local authorities that make decisions concerning permits and licenses for commercial operations, and in many countries provincial or state governments have a strong role in regulating public health and the environment. However, as a consequence of the limited access to dispute proceedings, subnational authorities are not able to fight their own battles, and they may have concerns that the federal government is not accurately representing their interests.²⁵⁵ Given that decentralization is occurring in one form or another in the majority of developing countries,²⁵⁶ this issue could become increasingly important in future disputes.

While significant progress has been made in the area of transparency, problems remain, particularly with regard to non-ICSID cases (see Section 7.1).

The Capacity of Developing Countries

The cost of arbitration and the technical capacity of developing countries to effectively represent themselves is also an important issue. As Salgado notes, “a

²⁵³Cosbey *et al.* 2004, at 7. Similarly, Gottwald 2007, at 256, suggests that, “[d]eveloping country counsel seeking to find relevant precedent are forced to engage in a kind of legal scavenger hunt through scattered and incomplete sources for past arbitral awards.”

²⁵⁴Blackaby 2004.

²⁵⁵Gaines 2002, at 108.

²⁵⁶See Larson and Ribot 2005.

tribunal's ability to reach fair and just results largely depends on its ability to consider all interests affected by the proceeding," which in turn depends on the parties being well represented.²⁵⁷ In any form of litigation, the level of expertise of a party's lawyers will likely be a decisive factor in the outcome of the dispute, but in the specialized area of investment arbitration the importance of having access to legal expertise is magnified.²⁵⁸

Hiring representation from an international law firm that has specialists in the field of investment arbitration has a number of significant advantages, such as access to past awards as mentioned above. However it is also very expensive. Gottwald notes that the hourly rates for lawyers in elite firms can range from US\$400 to US\$600.²⁵⁹ When a team of lawyers is retained for an arbitration proceeding that is drawn out over a period of several years, the result can be a "staggering" legal bill.²⁶⁰ The Czech Republic is reported to have spent US\$10 million to defend itself against two particular treaty claims and announced that it would spend US\$3.3 million in 2004 and US\$13.8 million in 2005 on its defense against more than a half-dozen new claims.²⁶¹

While developed countries will likely have sufficient in-house expertise, developing countries will generally not. For financial or tactical reasons, developing countries may nevertheless rely on government attorneys regardless of their experience or access to necessary resources. As Gottwald has found in a recent study, "this can lead to shocking disparities in the quality of legal representation between investor claimants and developing nation defendants."²⁶² Gottwald discusses one example where the Attorney General for the Seychelles, who had no prior experience with investor-state arbitration, defended an ICSID claim without access to a reliable Internet connection, Westlaw or Lexis-Nexis, or basic treatises on ICSID or investment arbitration. Similarly, at the commencement of the onslaught of claims against Argentina there was no access to fundamental substantive law or arbitration doctrine in the government legal office. While Argentina now has sub-

²⁵⁷Salgado 2006, at 1036.

²⁵⁸Gottwald 2007, at 252.

²⁵⁹*Ibid.*, at 254.

²⁶⁰*Ibid.*

²⁶¹*Ibid.*

²⁶²*Ibid.*

stantial expertise in the area, this is only as a result of having to defend numerous claims. According to Coe, an anecdotal survey of recent investor-state disputes “confirms that not infrequently one disputant faces significant resource limitations reflected in modest libraries, small teams of lawyers, and difficult choices about the use of counsels’ time.”²⁶³

Even assuming that developing countries have the resources to effectively defend their actions in arbitration, if they lose they may face considerable difficulty in paying the damages. While it is rather an extreme case, by 2006 Argentina was facing more than 30 claims for an estimated US\$17 billion in compensation, amounting to nearly the entire annual budget of the national government.²⁶⁴ The Czech Republic was obliged to pay more than US\$350 million in compensation to a Dutch investor, which according to one report meant a near doubling of the country’s public sector deficit.²⁶⁵ The cost of losing a case only reinforces the need for effective representation.

4.3.3 Uncertainty for Regulators

The main theme that runs through the discussion of regulative and procedural rules and norms of investment protection in relation to environmental issues and developing countries is *uncertainty*. The regulative rules and norms are vague and broad and therefore open to potentially expansive interpretation.²⁶⁶ There is a lack of transparency, thus making it difficult to evaluate how similar cases have been handled.

The lack of precision in the definition of regulative norms and rules of investment protection, which leads to uncertainty in how they will be interpreted and applied, is a common problem for many treaties and canonical statements of legal rules. As Chayes and Chayes point out, treaties:

frequently do not provide determinate answers to specific disputed questions. Language often is unable to capture meaning with precision. Treaty

²⁶³Coe 2006, at 1359-60.

²⁶⁴Van Harten 2007a, at 2. On the Argentine cases, see Kentin 2007; Schill 2007.

²⁶⁵IISD 2007, at 1.

²⁶⁶Bean and Beauvais 2003, at 58.

drafters do not foresee many of the possible applications-let alone their contextual settings. Issues that are foreseen often cannot be resolved at the time of treaty negotiation and are swept under the rug with a formula that can mean what each party wants it to mean. Economic, technological, scientific, and even political circumstances change. All these inescapable incidents of the effort to formulate rules to govern future conduct frequently produce a zone of ambiguity within which it is difficult to say with precision what is permitted and what is forbidden.²⁶⁷

However, in addition to individual provisions being imprecise, it is also the case in the area of investment protection that a multitude of IIAs with textual variations exist, which further increases the level of uncertainty about the obligations of states in a given dispute.²⁶⁸

Furthermore, it is only investors, who have no long-term interest in the interpretation of regulative rules and norms of investment protection, who are the potential claimants.²⁶⁹ As they are not parties to IIAs and the only obligations at issue are those imposed upon the state parties to the agreement, investors do not fear counterclaims and they may not even have an interest in pursuing arbitration to completion but instead anticipate that the threat of arbitration will induce settlement or the withdrawal of a government measure.²⁷⁰ As such, it is not surprising that investors will argue for the broadest possible interpretation of the regulative rules and norms of investment protection, and thus, arbitrators will hear, and may adopt, more expansive readings of provisions even when such an interpretation conflicts with the views of some or all of the states party to an agreement.²⁷¹

Also contributing to uncertainty is the fact that states may not even be aware of their obligations to certain investors. The nationality of a company is often neither easily identifiable or stable.²⁷² Changes in ownership, mergers, and even the adoption of 'flags of convenience' to access protection under IIAs mean that

²⁶⁷Chayes and Chayes 1993, at 188-9.

²⁶⁸Van Harten 2007a, at 27.

²⁶⁹Foy 2003, at 50.

²⁷⁰*Ibid.*, at 50-1; Kinnear 2005, at 8. On counterclaims see Veenstra-Kjos 2007, who suggests that it may be possible for a state to make a counterclaim against an investor, even in treaty arbitration, but that doing so is not simple or straightforward.

²⁷¹Van Harten 2007a, at 86.

²⁷²*Ibid.*, at 116.

governments may have to assume that all investors operating in their territory potentially have access to international arbitration.²⁷³ Furthermore, as claims may arise from the actions of courts or local authorities, who are not likely to be well informed on the intricacies of international investment law, the ability of governments to predict disputes is further limited.²⁷⁴

A more complicated issue is that of precedent. As Stone Sweet points out, precedent may help to legitimize decisions made in dispute resolution by “simultaneously acknowledging rule-making behaviour” and “constraining that same behaviour with a rule: that like cases shall be settled likewise.”²⁷⁵ As investment arbitrators do not have to base their decisions on those of previous tribunals, they may come to different conclusions about cases that are substantively similar.²⁷⁶ Franck argues that inconsistency in tribunal decisions creates uncertainty for both investors and states, contributing to a “looming legitimacy crisis” in investment arbitration.²⁷⁷ As mentioned above, there does appear to be an informal system of precedent emerging; however, Cheng argues that this informal system “imperfectly supports” public policy goals.²⁷⁸ Similarly, MacArthur questions the value of precedent, which might make the system “even more inflexibly resistant to public input,” in light of the concern that the system of arbitration has a pro-investor bias.²⁷⁹

Van Harten concludes that the uncertainty surrounding claims of breach of the regulative rules and norms of investment protection “makes a great deal of regulation inherently risky, wherever it is perceived to implicate multinational firms.”²⁸⁰ While it is also risky for an investor to make a claim that might turn out to be unfounded, the hazard is far greater for states, who alone are required to pay damages. As Gottwald notes, a significant implication of the uncertainty over treaty

²⁷³Mann 2003, at 250, provides the example of the *Aguas del Tunari v. Bolivia* case, where the investor was originally located in a tax shelter in the Caribbean but moved its head office to the Netherlands when the dispute arose in order to access the Netherlands-Bolivia BIT.

²⁷⁴Gagné and Morin 2006, at 366.

²⁷⁵Stone Sweet 1999, at 157.

²⁷⁶Houde and Yannaca-Small 2004, at 3.

²⁷⁷Franck 2005, at 1583.

²⁷⁸Cheng 2007, at 1016.

²⁷⁹MacArthur 2003, at 930.

²⁸⁰Van Harten 2007a, at 94.

standards is that it “may make developing nations *more prone to settling even spurious investor claims* rather than bear the expense of litigation and the risk of a financially devastating award.”²⁸¹

4.4 Summary

In this chapter, the key norms and rules of investment protection that are relevant to the protection of the environment have been analyzed. The key regulative norms and rules are: relative standards of treatment (national treatment and most-favoured-nation treatment); absolute standards of treatment (international minimum standard of treatment, fair and equitable treatment, and full protection and security); prohibition of expropriation without compensation (including indirect expropriation); prohibition of performance requirements; stability of host country law; and observance of obligations (umbrella clauses). The procedural norms and rules relate to the functioning of investment arbitration, including the selection of arbitrators, enforcement of awards, and challenges and annulment procedures.

It has been argued in this chapter that the regulative norms and rules of investment protection are decidedly vague and open to a significant degree of interpretation. There is the clear potential for environmental policy or court proceedings on environmental matters to be interpreted as conflicting with the regulative norms and rules of investment protection. However, the emergence and outcome of disputes remains difficult to predict given the broad scope for interpretation by arbitral tribunals and the absence of any system of precedent. Serious procedural issues, including the lack of transparency and accountability in investment arbitration, compound this uncertainty. Particular challenges exist for developing countries, which lack the financial and technical resources to deal with complex and costly arbitral proceedings.

²⁸¹ Gottwald 2007, at 260, emphasis added.

First-Order Outcomes

The basis by which foreign investors may challenge environmental policies was established in Chapter 4. This chapter delves into the complexities of actual cases that have been resolved in investment arbitration.

The cases assessed in this chapter are restricted to those that involve environmental regulation explicitly.¹ Limitations of time and space prevent consideration of a number of cases of relevance to the elucidation of the norms and rules discussed in the previous chapter even though some may be considered to border on environmental concerns.² Furthermore, there are several cases that do directly relate to environmental regulation that will not be considered here because at the time of writing they had not yet proceeded past the stage of the investor submitting a notice of arbitration.³

¹Environmental regulation is defined broadly to cover instances, e.g., where a contract is canceled for environmental purposes, or a permit is denied to an investor for reasons related to the environmental impact of the investment project.

²E.g., *Azinian et al. v. United Mexican States* ICSID Case No. ARB(AF)/97/2, *Waste Management Inc. v. United Mexican States* ICSID Case No. ARB(AF)/00/3.

³E.g., *Chemtura Corp. v. Government of Canada*, *V.G. Gallo v. Government of Canada*, *Sun Belt Water, Inc. v. Government of Canada*. See “NAFTA - Chapter 11 - Investment: Cases Filed Against the Government of Canada,” *Foreign Affairs and International Trade Canada website*, <http://www.international.gc.ca>.

The disputes that are reviewed cover a wide range of regulatory actions and several different environmental issues (e.g., hazardous waste, biodiversity loss, air and water pollution). Cases from developed countries (Canada and the US) are discussed, as are cases from the developing world (Peru, Costa Rica, and Mexico). Detailed description of the cases are provided in order to avoid over-simplification of the complex issues that are involved.

The purpose of this chapter is to identify the types of environmental measures that may be subject to arbitration and to glean from the decisions the possible range of interpretations of the norms and rules of investment protection in relation to environmental matters. While there is no attempt made in this chapter to judge whether a decision in a given case was *good* or *bad*, an appraisal is made of the tribunal's attempt to balance public and private interests.

The cases are divided into three types: those that have completed the jurisdictional phase of arbitration (a tribunal decided whether the investor/investment met the criteria required to qualify for an arbitral ruling, as set out in the IIA); those that have completed the merits phase of arbitration (a tribunal decided on the facts of the case); and those that are pending completion.

5.1 Cases Completing the Jurisdictional Phase

Awards on jurisdiction are important because they can prevent lengthy and costly proceedings in cases where investor claims are spurious or fall outside of the scope of an IIA or contract. However, it would seem that often tribunals find that the determination of jurisdiction requires the examination of evidence, and thus they join jurisdictional issues to the merits phase of the proceedings. There are therefore only a few awards related to environmental issues that deal solely with jurisdiction.

5.1.1 Ethyl v. Canada

This dispute, the first filed under Chapter 11 of the NAFTA to be resolved, concerned a Canadian law banning internal and international trade in a gasoline additive. An American investor claimed that the ban amounted to expropriation and

discriminatory treatment, and that it further constituted a prohibited performance requirement. The Tribunal, following UNCITRAL Rules, determined that it had jurisdiction to hear the case despite the objections of Canada. The Canadian government opted to settle rather than to proceed to the merits phase of arbitration.

Background

Methylcyclopentadienyl manganese tricarbonyl (MMT) is a fuel additive used to increase the level of octane in unleaded gasoline. The combustion of MMT produces manganese residues inside engines and emission control and monitoring systems, and releases airborne respirable manganese and unburned MMT into the atmosphere.⁴

In May 1995, the Government of Canada introduced Bill C-94, an act to regulate the importation of, and interprovincial trade in, certain manganese-based substances. Bill C-94 failed to pass through Parliament before the session ended in January 1996, but was reintroduced in April of that year as Bill C-29. Bill C-29 was enacted into law on 24 June 1997, banning the import and interprovincial trade of MMT except in cases where it would not be used as a gasoline additive. As MMT is not produced in Canada, the ban ensured the removal of MMT from all Canadian gasoline. Although in theory a company could establish manufacturing plants to produce MMT for sale within a single province, this would be highly unlikely to occur in practice. The particular approach of a trade ban was adopted by the government because it had been determined that MMT did not meet the requirements for prohibition under the Canadian Environmental Protection Act.⁵

The Dispute

Ethyl Corporation (Ethyl), incorporated under the laws of the State of Virginia and sole shareholder of Ethyl Canada Inc., was the developer and sole importer of MMT into Canada at the time of the ban. Ethyl filed a Notice of Intent to Submit to Arbitration under Chapter 11 of NAFTA and the UNCITRAL Rules

⁴*Ethyl Corporation v. Government of Canada*, Statement of Defence (*Ethyl* Statement of Defence), 27 November 1997, <http://www.international.gc.ca>.

⁵Gantz 2001, at 665.

on 10 September 1996 (prior to Bill C-29 being passed into law), and a Notice of Arbitration on 14 April 1997 (more than two months before the MMT Act came into force). Ethyl's Statement of Claim nevertheless relied on the MMT Act as the source of breach of several provisions of the NAFTA. Specifically, Ethyl argued that the ban amounted to expropriation of its investment, as well as breach of the national treatment standard and the prohibition on performance requirements.

Interestingly, in addition to claiming expropriation of its 'enterprise' (i.e. Ethyl Canada), Ethyl also claimed an expropriation of its 'goodwill'.⁶ Ethyl proposed that MMT was not harmful to public health or to the environment, but was being targeted by the automotive industry, which believed that the additive was damaging emission control monitoring systems in new vehicles.⁷ The company argued that by making public (and according to the company "unfounded") statements about the harmful effects of MMT, the government had created public fear and uncertainty about the product that in turn "substantially interfered with the corporate reputations, images and goodwill associated with Ethyl Corporation and Ethyl Canada" both within Canada and globally.⁸ In the opinion of Ethyl, such interference constituted measures tantamount to expropriation under NAFTA Article 1110. According to the reasoning of Ethyl, "[a]n expropriation ... exists whenever there is a substantial interference in the enjoyment of a property right."⁹

In terms of performance requirements, Ethyl pointed out that the ban was intended to act as an incentive to encourage local production of MMT.¹⁰ The company argued that it would have had to set up a plant in each Canadian province in order to sustain its share of the Canadian market.¹¹ It also claimed that the government sought to promote domestic ethanol production as an alternative to MMT and that the NAFTA prohibits measures that require a preference for domestic

⁶*Ethyl Corporation v. Government of Canada*, Notice of Intent to Submit Claim to Arbitration (*Ethyl* Notice of Intent), 10 September 1996, at 6, <http://www.international.gc.ca>.

⁷*Ibid.*, at 4.

⁸*Ibid.*, at 6-7.

⁹*Ethyl Corporation v. Government of Canada*, Notice of Arbitration (*Ethyl* Notice of Arbitration), 14 April 1997, at 11, <http://www.international.gc.ca>.

¹⁰*Ethyl* Notice of Intent, at 7.

¹¹*Ethyl Corporation v. Government of Canada*, Statement of Claim (*Ethyl* Statement of Claim), 2 October 1997, at 12, <http://www.international.gc.ca>.

goods.¹² Ethyl further claimed that the ban did not meet the stipulations of the exception to the prohibition on performance requirements (to be non-arbitrary, justified, not a disguised restriction on trade, and necessary to protect human health or the environment or the conservation of exhaustible natural resources).¹³ Ethyl suggested, based on GATT/WTO jurisprudence, that even if scientific evidence proving that MMT was a threat to health or the environment existed, in order for the ban to qualify as a *necessary* measure, it would have to be proved that it was the *least trade restrictive* measure available to the Canadian government.

Ethyl also argued that the measure was designed to discriminate between foreign and domestic investors, contrary to the national treatment standard.¹⁴ Ethyl argued that it was in ‘like circumstances’ with producers of other gasoline additives such as ethanol because the end products were indistinguishable to consumers.¹⁵ According to Ethyl, “[t]o violate the national treatment obligation, *it is not necessary to prove that discrimination has actually occurred*, only that it may occur since the requirement to provide equality of competitive opportunities extends to potential discrimination.”¹⁶

The company claimed US\$201 million in damages plus “costs associated with efforts to prevent the Government of Canada’s breach of its NAFTA obligations,” costs associated with the arbitration proceedings, and interest.¹⁷ In the Notice of Arbitration the company raised its damages claim to US\$250 million plus costs.¹⁸ In its Statement of Claim the damages were again raised to US\$251 million plus costs.¹⁹

Canada challenged the jurisdiction of the Tribunal to hear Ethyl’s claims, which it argued were outside the scope of Chapter 11. Firstly, Canada claimed that Ethyl’s action was premature, because at the time of Ethyl’s notice of arbitration, the MMT Act had not yet come into effect.²⁰ Secondly, Canada argued that

¹² *Ibid.*, at 9.

¹³ Ethyl Notice of Arbitration, at 14.

¹⁴ Ethyl Notice of Intent, at 10.

¹⁵ Ethyl Statement of Claim, at 9.

¹⁶ Ethyl Notice of Arbitration, at 9, emphasis added.

¹⁷ Ethyl Notice of Intent, at 11.

¹⁸ Ethyl Notice of Arbitration, at 19.

¹⁹ Ethyl Statement of Claim, at 13

²⁰ Ethyl commenced Chapter 11 proceedings before the legislative process was complete and before

Ethyl had failed to correctly follow the procedures for launching an arbitration laid out in the NAFTA.²¹ Canada also put forth that the MMT Act could not be considered a *measure relating to an investment*.²² Furthermore, the Government argued that if it was to be considered a measure under the NAFTA, it would have to be considered as relating to trade in goods, rather than relating to an investment, and thus subject to Chapter 3 of the NAFTA.²³

In its Statement of Defence, the government acknowledged that while high doses of airborne respirable manganese are known to be toxic, the environmental and health impacts of low-dose, long-term, exposure are unknown.²⁴ Nevertheless, Canada argued that clean air is an ‘exhaustible natural resource’ and that by damaging emission control technologies, MMT could increase the amount of airborne pollutants such as nitrous oxides, volatile organic compounds and carbon monoxide.²⁵ It also noted its international commitments to reducing emissions of such pollutants.²⁶ According to Canada, the ‘indirect potential effects’ of MMT on the environment and health made it inappropriate to regulate it through the Canadian Environmental Protection Act, but argued that “the absence of a pre-existing federal statutory authority to address the indirect hazards and risks associated with MMT use does not signify, as Ethyl infers, the absence of any environmental or health hazard.”²⁷

In response to the substantive claims of Ethyl, Canada pointed out that there was no distinction made in the MMT Act between nationals and non-nationals (all

the MMT Act had come into force. Even the Parliamentary debate on the Bill did not begin until 15 days after Ethyl submitted its Notice of Intent. The Notice of Arbitration was delivered after the third reading of the MMT Act in the Senate, but still before the legislative process was complete. The NAFTA procedures require that the Claimant wait six months following the events that give rise to a claim before submitting the claim to arbitration.

²¹ Specifically Articles 1119-1121 and 1137.

²² Article 1101.1 of the NAFTA states that Chapter 11 “applies to measures adopted or maintained by a Party *relating to*: (a) investors of another Party [or] (b) investments of investors of another Party in the territory of a Party.” (emphasis added).

²³ Ethyl Statement of Defence, at 10-12.

²⁴ *Ibid.*, at 13.

²⁵ *Ibid.*, at 17-18.

²⁶ *Ibid.*

²⁷ *Ibid.*, at 26.

were prevented from importing or interprovincially trading in MMT) and argued that the “substance of the measure, not solely the relevant industry structure at a given point in time, must be assessed to determine its effect on national treatment obligations,” otherwise every measure affecting a foreigner that was a sole supplier in a given market would be considered a breach of the national treatment standard.²⁸ Canada also rejected the claim that Ethyl was in ‘like circumstances’ with producers of other gasoline additives.²⁹ With regard to the claim that the MMT Act constituted a prohibited performance requirement, Canada argued that the purpose of the trade ban was to remove all MMT from gasoline in Canada, not to give preference to domestic production of the additive.³⁰ In the event that the Tribunal nevertheless found the ban to constitute a performance requirement, Canada argued that the exception *was applicable*, as the measure was necessary to prevent a negative impact on clean air (an exhaustible natural resource) and life and health.³¹ In response to the claim of expropriation, Canada argued that there had been no taking, and that in promulgating the MMT Act, the country was exercising its ‘police powers’ as recognized in international law.³²

On 11 March 1998, Mexico made a submission to the Tribunal.³³ The submission supported the position of Canada. Mexico argued that the dispute was not a Chapter 11 dispute (but rather related to issues of trade), and further noted that Chapter 11 does not apply to *proposed* legislation.³⁴

Prior to the release of the Tribunal’s Award, another dispute on the MMT Act outside of the NAFTA, initiated by several Canadian provinces, was concluded. The dispute settlement panel in that case found the MMT Act to be inconsistent with the Federal Government’s obligations under Canada’s Agreement on Internal Trade.³⁵

²⁸ *Ibid.*, at 29.

²⁹ *Ibid.*, at 30.

³⁰ *Ibid.*, at 31.

³¹ *Ibid.*, at 32.

³² *Ibid.*

³³ Under Article 1128 of the NAFTA, non-disputant parties to the agreement may make submissions on the interpretation of the treaty

³⁴ *Ethyl Corporation v. Government of Canada*, Article 1128 Submission of the United Mexican States, 11 March 1998, <http://www.economia-snci.gob.mx>.

³⁵ Swan 2000, at 160.

Outcome

The NAFTA Tribunal produced its Preliminary Award on Jurisdiction on 24 June 1998.³⁶ The Tribunal found that the claims Canada had made with regards to procedural failings on the part of Ethyl did not amount to a jurisdictional challenge. In the view of the Tribunal, under the UNCITRAL Rules the fundamental jurisdictional issue was consent to arbitration, which Canada provided when it ratified the NAFTA.³⁷ The only relevant question, therefore, was whether the claims made by Ethyl fell within the bounds of what Canada had consented to submit to arbitration. The tribunal agreed with Canada and Mexico that a proposed piece of legislation did not constitute a ‘measure’. Nevertheless, as the MMT Act had subsequently come into force, the only problem was that Ethyl had not waited the required six months to initiate proceedings, which the Tribunal viewed as a procedural rather than a jurisdictional issue.³⁸ This conclusion was drawn despite the Tribunal’s acknowledgment that Ethyl “may have ‘jumped the gun’ for tactical reasons relating to the legislative process,” and “may have decided to file its Notice of Intent on 10 September 1996 *for the purpose of affecting that debate*.”³⁹

The Tribunal joined the issues of whether the MMT Act related to trade in goods or to an investment and whether Ethyl could claim damages to its goodwill and reputation outside of Canada to the merits phase of the proceedings, dismissing all other jurisdictional challenges.⁴⁰ However, the tribunal did place the burden of the costs of the jurisdictional phase that were related to the debate over procedural issues on Ethyl.⁴¹

Canada settled with Ethyl in July 1998, less than one month after the Tribunal made its award on jurisdiction. Canada agreed to reverse the ban on MMT, to pay Ethyl US\$13 million in legal fees and damages, and to issue a statement declaring that current scientific information did not demonstrate any harmful effects of MMT to health or automotive systems.

³⁶ *Ethyl Corporation v. Government of Canada*, Preliminary Award on Jurisdiction, 24 June 1998, <http://www.international.gc.ca>. Reproduced in 38 *ILM* (1999), at 700.

³⁷ *Ibid.*, at para. 60.

³⁸ *Ibid.*, at para. 69

³⁹ *Ibid.*, at para. 87, emphasis added.

⁴⁰ *Ibid.*, at para. 96

⁴¹ *Ibid.*

One of the explanations given for why Canada chose to settle is that it had already lost a domestic challenge to the ban.⁴² However, the panel in the internal trade case expressly stated that the withdrawal of the MMT Act was not recommended, and furthermore that case did not relate to the international ban, but only to the interprovincial one.⁴³ Others therefore hypothesize that the Canadian government settled because it was concerned about the large amounts of money that it had spent on the arbitration and the huge damages it could be expected to pay Ethyl if it lost the case.⁴⁴

5.1.2 Lucchetti v. Peru

This case concerns the construction and operation of a pasta factory adjacent to an ecological reserve in Peru. Local governments revoked the operating licence for the Chilean-owned factory, forcing it to close, following allegations of environmental misconduct. The investor brought a claim under the Chile-Peru BIT; a rare instance of a South-South agreement being invoked in a dispute. The IC-SID Tribunal found that it did not have jurisdiction to hear the merits of the case because the dispute had ‘crystallized’ prior to the entry into force of the BIT. An Annulment Committee declined to overturn the Tribunal Award.

Background

Empresas Lucchetti, S.A. a Chilean company, is the majority shareholder of Lucchetti Perú, S.A., (collectively ‘Lucchetti’) which was the owner of an industrial plant for the manufacture of pasta situated in the district of Chorrillos in the City of Lima, Peru. The plant was situated close to, but not within, a protected wetland called Pantanos de Villa.

In August 1997, the Municipality of Chorrillos issued a stop work notice to Lucchetti, followed on 25 September by Decree 111, issued by the Council of the Municipality of Lima, which ordered work on the construction of the plant to cease immediately. The Decree also established a Commission, which reported in

⁴²Gaines 2002, at 110; Gudofsky 2000, at 303.

⁴³Mann 2001, at 73.

⁴⁴Jones 2002, at 542.

October that Lucchetti had “violated specific provisions of the National Construction Regulations, the Environmental Code, rules and agreements on environmental protection and the Regulations on Construction Licenses.”⁴⁵ The Commission also suggested that the plant posed “an imminent environmental threat to the Natural Protected Area of Pantanos de Villa.”⁴⁶ The Council of the Municipality of Lima followed up on the Commission’s report with a further Decree (126) on 21 October, which established a ‘Special Regulatory Zone of Pantanos de Villa’ and suspended all construction permits and licences within that zone. A further Decree (01) on 2 January 1998 annulled Lucchetti’s permits.⁴⁷

The company challenged the annulment of the permits and the grounds on which they were based in the domestic courts of Peru.⁴⁸ Four separate judgments resulted, all in favour of Lucchetti.⁴⁹ The company was granted suspension of Article 4 of Decree 01, Decree 126, and the stop work notice. Thereafter, on 4 September 1998, the Council of the Municipality of Lima promulgated Ordinance 184, which established a comprehensive environmental regulatory scheme for the area and required company activities to be brought into compliance within five years. Lucchetti successfully challenged the Ordinance in the courts. Work was permitted to proceed and in December 1999, the Municipality de Chorrillos granted Lucchetti its construction and operating licenses.

In August 2001 the Council of the Municipality of Lima promulgated Decrees 258 and 259. Decree 258 was designed to establish a regulatory framework for the permanent protection of the Pantanos de Villa as an ecological reserve. It authorized the municipal authorities of Lima to adopt measures to achieve that objective and contained a provision charging the Mayor of Lima to present the Peruvian legislature with proposals for the expropriation of all areas necessary for the permanent preservation, maintenance, and protection of the Ecological

⁴⁵Qtd. in *Empresas Lucchetti, S.A. and Lucchetti Perú, S.A. v. Republic of Peru*, ICSID Case No. ARB/03/4, Award (*Lucchetti Award*), 7 February 2005, at para. 29(ii), <http://icsid.worldbank.org>. Reproduced in 19 *ICSID Review* (2004), at 359.

⁴⁶*Ibid.*

⁴⁷*Lucchetti Award*, at para. 19.

⁴⁸*Ibid.*, at para. 31.

⁴⁹*Ibid.*, at para. 32.

Reserve.⁵⁰ Decree 259 specifically revoked the operating license of Lucchetti, and required that the plant be closed and demolished within 12 months. The Decree lists the following reasons for this action: Lucchetti's failure to comply, since 1997, with the legal rules applicable the construction of the plant near the Pantanos de Villa, thus endangering that ecological reserve; Lucchetti's attempts to thwart the municipality's efforts to protect the region's environment in the courts; and the evidence (contained in testimony before a congressional committee) indicating that there was corruption in the procurement of the court judgments in Lucchetti's favour.⁵¹

The Dispute

Lucchetti submitted a Request for Arbitration, on the basis of a BIT between Peru and Chile,⁵² to ICSID on 24 December 2002. Lucchetti alleged that Peru had breached Article 3.2 of the Peru-Chile BIT on the promotion and protection of investments, Article 4.1 on fair and equitable, national and most-favoured-nation treatment, and Article 6.1 on expropriation. The company sought damages, costs and interests, and indicated that their investments in Peru had been worth more than US\$150 million.⁵³

Peru objected to the jurisdiction of the Tribunal on the following grounds: the dispute arose in 1997, while the Chile-Peru BIT did not enter into force until 3 August 2001, and the provisions of the BIT do not apply to disputes that arose before the BIT entered into force (Article 2); the dispute was previously submitted to the domestic courts of Peru and the BIT has a 'fork in the road' provision (Article 8); and the plant is not covered as a protected 'investment' under the BIT because the Claimants violated the laws and regulations of Peru governing the construction and operation of their plant (Articles 1 and 2).⁵⁴ With regards to the latter point, Peru contended that the company had commenced construction:

⁵⁰ Qtd. in *Lucchetti Award*, at para. 20.

⁵¹ *Ibid.*, at para. 21.

⁵² Convenio Entre el Gobierno de la Republica del Peru y el Gobierno de la Republica de Chile para la Promocion y Proteccion Reciproca de las Inversiones, 2 February 2000.

⁵³ *Lucchetti Award*, at para. 17.

⁵⁴ *Ibid.*, at para. 25.

without obtaining the necessary urban habilitation and environmental approvals and that their approach throughout the construction process was to build their plant quickly, without regard for Peruvian laws and regulations, in the expectation that they could then present a *fait accompli* to the municipal authorities who would feel pressured to approve the project and grant the necessary permits after the fact.⁵⁵

Peru also made claims that the circumstances under which the company had attained favourable judgment in the domestic courts were “corrupt and egregious” and suggested that for the Tribunal to attribute “any preclusive significance to those illicitly obtained judgments for purposes of permitting Claimants to gain access to the ICSID forum would constitute a gross miscarriage of justice and subvert the rule of law.”⁵⁶

Lucchetti countered that the dispute did not relate to the annulment of their permits in 1997/98, an issue which had been dealt with in the domestic courts, but related only to Decree 258 and 259 which were promulgated by the Municipality of Lima in 2001, following the entry into force of the BIT. This dispute had not been taken before the domestic courts and therefore, in the Lucchetti’s view, the fork in the road provision did not apply. The company also denied that their investment in Peru had violated any national laws or regulations.⁵⁷ They further suggested that the opposition to the plant of the Mayor of Lima was motivated by political considerations, rather than concern for the environment.⁵⁸

Outcome

The Tribunal issued its Award on 7 February 2005. The Tribunal decided that the dispute had ‘crystallized’ in 1998, and was not a ‘new dispute’ as claimed by Lucchetti.⁵⁹ The Tribunal based this decision on the fact that the reasons for the adoption of Decrees 258 and 259 in 2001 were:

⁵⁵ *Ibid.*, at para. 28.

⁵⁶ *Ibid.*, at para. 37.

⁵⁷ *Ibid.*, at para. 25.

⁵⁸ *Ibid.*, at para. 28.

⁵⁹ *Ibid.*, at para. 53.

... directly related to the considerations that gave rise to the 1997/98 dispute: the municipality's stated commitment to protect the environmental integrity of the Pantanos de Villa and its repeated efforts to compel Claimants to comply with the rules and regulations applicable to the construction of their factory in the vicinity of that environmental reserve.⁶⁰

The Tribunal rejected the Claimant's argument that Decree 01 and Decrees 258/259 were substantially different, the former dealing with the issue of construction, and the latter addressing environmental concerns, finding that all dealt with environmental issues in both the construction and operation of the plant.⁶¹ They also rejected the notion that the time lag between the court judgments and the 2001 Decrees made the disputes distinct.⁶² Finally, they dismissed the argument that the dispute should be seen as discrete from the one resolved in Peru's courts because it concerned a violation of treaty rights. The Tribunal noted that the company could hardly claim that it had made its investment with the expectation that it could rely on access to arbitration, given that such a remedy was unavailable "until years after Lucchetti had acquired the site, built its factory, and was well into the second year of full production."⁶³ While the Tribunal did not delve into the question of whether the domestic court judgments in favour of Lucchetti had been tainted by corruption, they did note that if such corruption could be proved it would provide an independent ground for the conclusion that the court proceedings had not terminated the original dispute.⁶⁴ The Tribunal concluded that because the dispute had 'crystallized' prior to the entry into force of the BIT, it had no jurisdiction to hear the merits of Lucchetti's claim. The Tribunal awarded costs of the arbitration to be born equally between the parties.

On 6 June 2005, Lucchetti submitted to ICSID a Request for Annulment of the Tribunal's Award. Lucchetti argued for the annulment of the Tribunal Award on three grounds, which found their basis in the ICSID Convention : (i) manifest excess of powers; (ii) failure to state reasons; and (iii) serious departure from a

⁶⁰ *Ibid.*

⁶¹ *Ibid.*, at para. 55.

⁶² *Ibid.*, at para. 56.

⁶³ *Ibid.*, at para. 61.

⁶⁴ *Ibid.*, at para. 57.

fundamental rule of procedure.⁶⁵ A Committee was formed to rule on the annulment.

With regard to the charge of manifest excess of powers, Lucchetti claimed that the Tribunal:

... arrogated to itself an authority it did not properly possess, to determine that a government measure taken after an investment treaty's entry into force fell outside that treaty's coverage, simply because its 'subject matter' was the same as earlier government measures which were formally, legally and irrevocably invalidated by the local courts, and because the government never ceased to resent this chapter of history and continued to stir the flames of public opinion. By deferring to public opinion and the government's subjective beliefs rather than recognised legal principles ... the Tribunal also failed to apply the proper law ... [and] failed to exercise the jurisdiction that it properly possessed.⁶⁶

In Lucchetti's view, the fact that the dispute had historical antecedents was irrelevant: the date on which the government promulgated Decrees 258 and 259 (following the entry into force of the BIT) was the date that Lucchetti's rights were violated and its investment destroyed.⁶⁷ Lucchetti also argued that the Tribunal had "disregarded the legal principles that govern finality of disputes and the related principles of repose and vested rights in the country in question" when it concluded that Decrees 258 and 259 were related to a dispute that had been conclusively resolved in the courts of Peru.⁶⁸

With regard to the second charge, Lucchetti argued that the Tribunal's approach departed from the "fundamental rule of procedure in international cases under which jurisdiction is to be based on the claimant's formulation of its claims,

⁶⁵ ICSID Convention, at Art. 52.1(b),(d), and (e).

⁶⁶ *Industria Nacional de Alimentos, S.A. and Indalsa Perú, S.A. v. Republic of Peru*, ICSID Case No. ARB/03/4, Decision on Annulment, 5 September 2007, at para. 31, <http://icsid.worldbank.org>. The companies involved in the dispute changed their names to Industria Nacional de Alimentos, S.A. (previously Empresas Lucchetti, S.A.) and Indalsa Perú, S.A. (previously Lucchetti Perú, S.A.), but in the Decision the two Claimants are treated as one unit, and the name 'Lucchetti' is used to refer to both of them.

⁶⁷ *Ibid.*, at para. 36.

⁶⁸ *Ibid.*, at para. 39.

not on the respondent's defence."⁶⁹ Lucchetti claimed that it had not been given the opportunity to prove that the stated reason for Decree 259 (i.e. environmental concern) was mere pretext, disguising ulterior motives. As such, the Tribunal based its assumption that the dispute was a continuation of the previous one only on the statements of Peru. Furthermore, Lucchetti argued that in implicitly accepting the allegations of corruption, the tribunal violated the company's right to be presumed innocent of a criminal offence.

Lucchetti also claimed that the Tribunal presented contradictory reasons for the decision on jurisdiction by basing the Award on "different and inconsistent standards."⁷⁰ Furthermore, Lucchetti argued that the Tribunal failed to deal with several of the arguments that it had put forward in its original claim, including the argument that the preamble to Decree 259 (relating to concern for the environment) was merely a pretext and that the real reasons for the Decree were political.⁷¹

For its part, Peru argued that the Tribunal had not manifestly exceeded its powers, departed from fundamental rules of procedure or failed to state its reasons in the Award. Furthermore, Peru argued that what Lucchetti was seeking was not an annulment, but an appeal:

... even if the reasons in the Award were wrong, this would not justify annulment of the Award, because it is not within the province of an ad hoc committee to review a tribunal's finding that it lacked jurisdiction. Lucchetti's request for annulment is in reality an appeal against the Tribunal's decision that it did not have jurisdiction *ratione temporis* under Article 2 of the BIT. Appeals are not permitted, and the Committee may not review the Tribunal's findings of fact and law.⁷²

The Decision on Annulment was dispatched to the parties on 5 September 2007. The Committee for the most part agreed with the position of Peru, and made it clear that it was not its task to determine whether or not the Tribunal had interpreted the BIT correctly. The Committee suggested that "treaty interpretation is not an exact science, and it is frequently the case that there is more than

⁶⁹*Ibid.*, at para. 46.

⁷⁰*Ibid.*, at para. 51.

⁷¹*Ibid.*, at para. 52.

⁷²*Ibid.*, at para. 57.

one possible interpretation of a disputed provision, sometimes even several.”⁷³ The Committee highlighted that rather than assessing a tribunal’s reasoning, the purpose of an annulment proceeding is to examine the *process* by which a tribunal arrives at its decision.

In regard to Lucchetti’s first charge, on manifest excess of powers, the Committee noted that “the Tribunal’s interpretation of Article 2 of the BIT, as it appears in the Award, does not reflect all relevant aspects of treaty interpretation according to the Vienna Convention.”⁷⁴ However, despite this conclusion, the Committee found no basis to conclude that the Tribunal disregarded the widely accepted rules of treaty interpretation or that the Tribunal’s reasoning in the Award constituted an excess, let alone a *manifest* excess, of their powers.

As for Lucchetti’s second claim, relating to departure from a fundamental rule of procedure, the Committee found that the company had been given ample opportunity to present arguments at the jurisdictional stage with regard to the motives behind Decrees 258 and 259. While the Tribunal could have called for documents or evidence to be presented, or joined jurisdictional issues to the merits phase in order to allow the factual basis of claims to be further explored, the fact that it did not do so did not amount, in the opinion of the Committee, to a violation of a fundamental rule of procedure.⁷⁵ Furthermore, as the Tribunal did not examine the issue of corruption in the domestic legal proceedings, and only suggested that *if* corruption could be proved that it would provide an independent basis for their conclusion that the original dispute had not been resolved, the Committee reasoned that there could be no violation of Lucchetti’s right to be presumed innocent.⁷⁶

Finally, with regard to Lucchetti’s claim that the Tribunal failed to state its reasons, the Committee found that while the Award did not provide a “full picture of the various elements which should be taken into account for treaty interpretation under the Vienna Convention” it did refer to various standards adopted in international case-law and doctrine and set out the elements which the Tribunal found conclusive. The Committee was also satisfied that the Tribunal examined

⁷³*Ibid.*, at para. 112.

⁷⁴*Ibid.*, at para. 116.

⁷⁵*Ibid.*, at para. 123.

⁷⁶*Ibid.*, at para. 124.

all of Lucchetti's arguments.⁷⁷

The Committee, therefore, while finding flaws in the Tribunal Award, did not find that the standards for annulment had been met. One arbitrator dissented, finding that there were sufficient grounds for an annulment.⁷⁸ The costs of the annulment proceeding were divided between the parties.

5.2 Cases Completing the Merits Phase

Several investor-state disputes related to environmental protection have been decided on the merits. These cases have certain similarities, but in other respects are not easily comparable. The arguments of investors and states and the decisions of tribunals made in these cases indicate certain trends in investment arbitration, but they also raise numerous questions about the interpretation of norms and rules of investment protection.

5.2.1 Santa Elena v. Costa Rica

This case is distinguishable from the rest of the cases discussed in this section by the fact that it involves a *direct* expropriation of property for the purpose of the protection of the environment. The issues in this case revolve only around the appropriate level of compensation to be provided to the aggrieved investor. Costa Rica argued that a number of factors, including the public purpose of the measure and the development status of the country, should be taken into account in the calculation of damages. However, the ICSID Tribunal disagreed, and found that the duty to pay compensation is unaffected by such considerations.

Background

In 1978, the Costa Rican government expropriated a property in the northwest corner of the country owned by a Costa Rican company, Compañía del Desarrollo de Santa Elena, S.A. (Santa Elena), the majority of whose shareholders were

⁷⁷*Ibid.*, at para. 129.

⁷⁸The dissenting opinion is attached to the Annulment Decision.

American citizens. The company had intended to develop the property, which it had acquired for a sum of approximately US\$395,000, as a tourist resort and residential community.⁷⁹

The area expropriated was composed of tropical dry forest, known to contain “flora and fauna of great scientific, recreational, educational, and tourism value” as well as beaches of particular importance for nesting sea turtles.⁸⁰ The area was also adjacent to the Santa Rosa National Park. The stated purpose of the expropriation was the expansion of the park for the preservation of biodiversity. The area of the park prior to the expansion was insufficient to maintain stable populations of large feline species such as pumas and jaguars.⁸¹

Costa Rican law requires that a property expropriated for a public purpose must be dedicated to that purpose within ten years, and thus the government issued a decree on 25 July 1987, expanding the boundaries of the park so as to incorporate the Santa Elena property.⁸²

The Dispute

After making an appraisal of the value of the property, Costa Rica initially offered Santa Elena the sum of approximately US\$1.9 million.⁸³ This proposal was rejected, and the company countered with a proposed sum of approximately US\$6.4 million, in accordance with an appraisal of the property that they had commissioned.⁸⁴ A long period of domestic court battles ensued. The company sought annulment of the 1978 Decree and separately petitioned against the 1987 Decree. The company pursued these claims as far as the Supreme Court of Costa Rica, but lost in every instance.⁸⁵ In 1992, negotiations on a settlement for compensation were recommenced and a new appraisal was conducted on behalf of the

⁷⁹ *Compañía del Desarrollo de Santa Elena, S.A. v. Costa Rica*, ICSID Case No. ARB/96/1, Final Award (*Santa Elena* Final Award), 17 February 2000, at para. 16, <http://icsid.worldbank.org>. Reproduced in 39 *ILM* (2000), at 1317.

⁸⁰ Expropriation Decree, qtd. in *ibid.*, at para. 18.

⁸¹ *Ibid.*

⁸² *Santa Elena* Final Award, at para. 22.

⁸³ *Ibid.*, at para. 17.

⁸⁴ *Ibid.*, at para. 19.

⁸⁵ Brower and Wong 2005, at 751.

government in 1993, which valued the property at US\$4.4 million.⁸⁶

In May 1995, the company filed a Request for Arbitration with ICSID, which was officially lodged with the Centre in March 1996 (the delay was at the request of Santa Elena). Costa Rica was not obliged to participate in international arbitration under an IIA, but agreed to do so in response to diplomatic pressure and economic sanctions (specifically the delay of a US\$175 million Inter-American Development Bank loan at the behest of the US government).⁸⁷

There was no disagreement between Costa Rica and Santa Elena that the expropriation had been lawful. What was in dispute was the amount of compensation due to Santa Elena. The parties agreed that the appropriate standard of compensation was the fair market value of the property.⁸⁸ However, the parties were not in agreement on the appropriate method to calculate the fair market value or the date on which this value was to be assessed, as this depended in part on the law applicable to the dispute. Under Costa Rican law, the value of an expropriated property is determined at the time that compensation is provided. Under international law, the value of expropriated property is assessed at the time of the expropriation, which in this case would be 1978. The former method would likely yield a higher value for the property, and thus a greater amount of compensation, and was therefore favoured by Santa Elena.⁸⁹ For the same reasons, Costa Rica favoured the application of international law. Costa Rica also argued that if the Tribunal found that Costa Rican law was applicable to the case, environmental legislation developed since 1978, that would significantly restrict, if not prohibit outright, the commercial development of the property should be taken into account in the valuation. In particular, Costa Rica noted that the Guanacaste Conservation Area (which surrounded the expropriated area) was listed as a World Heritage Site in 1999.⁹⁰ Costa Rica also provided detailed evidence on its international

⁸⁶*Ibid.*

⁸⁷*Santa Elena* Final Award, at para. 24. Brower and Wong 2005, at 751, suggest that it is likely that the company would have actually preferred to rely on the pressure imposed by US to reach a favourable settlement, rather than having to pay for an expensive and lengthy arbitration, and that it was rather Costa Rica that pushed for the latter option in order to avoid an unfair settlement.

⁸⁸*Santa Elena* Final Award, at para. 70.

⁸⁹Brower and Wong 2005, at 757-8.

⁹⁰Brower and Hellbeck 2001, at 25.

obligations to protect the environment, including MEAs and the 1940 Western Hemisphere Convention.⁹¹ The country argued that setting the compensation too high would discourage states (particularly those in the developing world) from adopting environmental objectives.

The Claimant requested an award in the amount of US\$41.2 million plus interest and other amounts (later revised to US\$40,337,750).⁹² Costa Rica proposed an alternative sum of US\$1,919,492 or, in the event that Costa Rican law was applied, US\$2,965,113.68.⁹³

Outcome

The Tribunal rendered its Final Award on 17 February 2000. The Tribunal accepted that the expropriation occurred on 5 May 1978 (the date the Decree was in effect), arguing that there was no evidence that the property was devalued by any prior public knowledge that it was about to be expropriated. The Tribunal further decided that in the absence of an explicit agreement on what law would govern the dispute, international law would be applied. The Tribunal found that the reasonable and fair approximation of the value of the property lay between the value attributed by Costa Rica in 1978 (US\$1.9 million) and the Santa Elena's 1978 valuation (US\$6.4 million), and thus came to the amount of US\$4,150,000.⁹⁴ Taking into account interest, the final sum that the Tribunal arrived at was US\$16 million.⁹⁵ The costs of the arbitration were borne equally by the parties.

The Award is particularly significant for several statements made on the relationship between the public purpose of an expropriation and the requirement of compensation:

While an expropriation or taking for environmental reasons may be classified as a taking for a public purpose, and thus may be legitimate, the fact that the Property was taken for this reason *does not affect either the nature or the measure of the compensation to be paid for the taking*. That is,

⁹¹*Ibid.*, at 764.

⁹²*Santa Elena* Final Award, at para. 29.

⁹³*Ibid.*, at para. 35.

⁹⁴*Ibid.*, at para. 95.

⁹⁵*Ibid.*, at para. 107.

the purpose of protecting the environment for which the Property was taken does not alter the legal character of the taking for which adequate compensation must be paid. *The international source of the obligation to protect the environment makes no difference.*⁹⁶

And further:

Expropriatory environmental measures-no matter how laudable and beneficial to society as a whole-are, in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state's obligation to pay compensation remains.⁹⁷

5.2.2 Metalclad v. Mexico

This was the first NAFTA Chapter 11 dispute to be decided on its merits, and quite possibly the most controversial of any investor-state dispute concluded to date. The case revolves around the construction and operation of a hazardous waste facility in Mexico. The American investor involved in the dispute sought compensation for breach of the minimum standard of treatment (including fair and equitable treatment and full protection and security), national treatment, most-favoured-nation treatment, as well as expropriation and use of prohibited performance requirements, following the denial of a municipal construction permit and ongoing public demonstrations against the company's operations. An ICSID Additional Facility Tribunal ruled in favour of the investor. Mexico challenged the award in a Canadian court, which partially annulled the award but still required Mexico to compensate the investor.

Background

In 1993, Ecosistemas Nacionales, S.A. de C.V., a Mexican corporation wholly-owned by Eco-Metalclad, which in turn is a subsidiary of Metalclad Corporation,

⁹⁶*Ibid.*, at para. 71, emphasis added.

⁹⁷*Ibid.*, at para. 72.

incorporated in the US (collectively ‘Metalclad’), purchased the Mexican company Confinamiento Tecnico de Residuos Industriales, S.A. de C.V. (Coterin), which had obtained permits from Mexico’s National Ecological Institute (INE) to construct and operate a hazardous waste transfer station in the Municipality of Guadalcazar in the State of San Luis Potosi.⁹⁸ Metalclad endeavored to expand the transfer station into a toxic waste processing plant and landfill and, in its opinion, secured the necessary Mexican state and federal permits to do so.

According to Metalclad, shortly after the purchase of Coterin, the Governor of San Luis Potosi embarked on a public campaign to denounce the company and prevent the operation of the landfill.⁹⁹ The site had a contentious history of environmental misconduct prior to Metalclad’s involvement, and was viewed with concern and suspicion by the local community.¹⁰⁰ The company entered into negotiations with the State government, and claimed that it eventually secured their support of the project (a fact that Mexico denied in the course of the arbitration).¹⁰¹ Metalclad began work on the development of the landfill in May 1994.

In October of the same year, the Municipality of Guadalcazar ordered the cessation of all building activities due to the absence of a municipal construction permit.¹⁰² Metalclad subsequently applied for the municipal construction permit, and according to the company, it had the assurance of the federal government that it was a simple formality and that the application would be approved in due course.¹⁰³ Without yet receiving the municipal permit the company resumed construction on the site, completing the landfill in March 1995.¹⁰⁴

However, an inauguration ceremony was blocked by public demonstrations. Metalclad claimed that it was thenceforth effectively prevented from opening the

⁹⁸ *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award (*Metalclad* Award), 30 August 2000, at paras. 2, 28 and 29, <http://icsid.worldbank.org>. Reproduced in 40 *ILM* (2001), at 36.

⁹⁹ *Ibid.*, at para. 37.

¹⁰⁰ *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Counter-Memorial (*Metalclad* Counter-Memorial), 17 February 1998, at paras. 40-4, <http://www.naftaclaims.com>.

¹⁰¹ *Metalclad* Award, at para. 38.

¹⁰² *Ibid.*, at para. 40.

¹⁰³ *Ibid.*, at paras. 41-2.

¹⁰⁴ *Ibid.*, at para. 45.

landfill.¹⁰⁵ The company entered into negotiations with the INE and the Mexican Federal Attorney's Office for the Protection of the Environment (PROFEPA) to resolve the problem, resulting in an agreement (the Convenio) in November 1995.¹⁰⁶ The Convenio stated that an environmental audit of the site had been carried out from December 1994 through March 1995. The audit detected certain deficiencies, and Metalclad was required to submit an action plan to correct them including a corresponding site remediation plan. The Convenio also required PROFEPA to create a Technical-Scientific Committee to monitor the remediation. The Convenio provided for a five-year term of operation for the landfill, renewable by the INE and PROFEPA. The Governor of San Luis Potosi denounced the Convenio shortly after it was publicly announced, and it was also the subject of a court action and a complaint by the NGO Greenpeace.¹⁰⁷

On 5 December 1995, Metalclad's application for a municipal construction permit was denied.¹⁰⁸ On 8 February 1996, the INE granted Metalclad an additional permit authorizing the expansion of the landfill capacity from 36,000 tons per year to 360,000 tons per year. From May 1996 through December 1996, Metalclad and the State of San Luis Potosi attempted to resolve their issues with respect to the operation of the landfill, but these efforts failed. On 23 September 1997, three days before the expiry of his term, the Governor issued an Ecological Decree declaring a Natural Area (encompassing the landfill site) for the protection of rare cactus.¹⁰⁹

The Dispute

In 1996, Metalclad notified Mexico of its intention to file a dispute under Chapter 11 of the NAFTA, which it did in January of the following year. Metalclad's request for US\$90 million in compensation was based on a claim of expropriation (Article 1110), a breach of the minimum standard/fair and equitable treatment (Article 1105), a breach of the national treatment (Article 1102) and most-

¹⁰⁵ *Ibid.*, at para. 46.

¹⁰⁶ *Ibid.*, at para. 47.

¹⁰⁷ *Metalclad* Counter-Memorial, at para. 65.

¹⁰⁸ *Metalclad* Award, at para. 49.

¹⁰⁹ *Ibid.*, at para. 59.

favoured-nation treatment (Article 1103) standards, and use of prohibited performance requirements (Article 1106). The tribunal operated under the rules of the ICSID Additional Facility, as Mexico is not party to the ICSID Convention, and the proceedings took place in Vancouver, British Columbia, Canada.

In its Memorial, Metalclad argued that the NAFTA provided guidance on the interpretation of the international minimum standard in its preamble which states that the purpose of the agreement is to “ensure a *predictable* commercial framework for business planning and investment.”¹¹⁰ Metalclad further argued that the standard should be read in light of the objectives of the NAFTA laid out in Article 102. In Metalclad’s view, the minimum standard thereby also enveloped the principles of non-discrimination (national and most-favoured-nation treatment) and *transparency*. Having established an interpretation of Article 1105, Metalclad proceeded to argue that Mexico’s conduct had not met the requirements of the standard, leaving the company “in a tenebrous investment climate, full of bewilderment, bereft of predictability.”¹¹¹ The company also claimed that it had been denied full protection and security.¹¹²

The claims regarding breach of Articles 1102 and 1103 were based on the fact that the Municipality of Guadalcázar did not require construction permits from any national investors or other foreign investors.¹¹³ In terms of performance requirements, Metalclad argued that it had effectively been forced to provide proprietary information to the state government on how to construct a landfill, as well as to offer certain services to the local community, such as free medical care, and free consultations for the government regarding hazardous waste matters.¹¹⁴

Finally, Metalclad addressed the issue of expropriation, arguing that the deprivation of its vested right to operate the landfill was irreversible. Metalclad further suggested that the taking had not been for a public purpose, noting that at best it had been for a ‘political purpose’ and at worst for personal gain. In Metalclad’s view, the taking had also been discriminatory and implemented without due

¹¹⁰ *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Memorial (*Metalclad* Memorial), 13 October 1997, at para. 162, emphasis added by Metalclad.

¹¹¹ *Ibid.*, at para. 165.

¹¹² *Ibid.*, at para. 212.

¹¹³ *Ibid.*, at paras. 214 and 228.

¹¹⁴ *Ibid.*, at para. 235.

process.¹¹⁵ While arbitration proceedings were initiated prior to the Governor issuing the Ecological Decree, Metalclad nevertheless subsequently sought to have this measure considered by the tribunal as an expropriation. In terms of compensation, Metalclad argued that the fair market value of the investment included lost future profits.¹¹⁶

Mexico disputed many of the facts raised in the Metalclad's Memorial, pointing out that Coterin had been denied a municipal construction permit in 1991, prior to Metalclad's purchase of the site, and arguing that it was always clear to the company that it would have to acquire the necessary permits and solicit local approval for the project.¹¹⁷ Mexico further argued that the company had misrepresented itself to various levels of government, engaged in unethical and at times unlawful behaviour, and was neither competent nor financially capable of running a hazardous waste landfill in a safe and effective manner.¹¹⁸

In terms of the relevant provisions of the NAFTA, Mexico first argued that it could not be held liable for any actions taken prior to the entry into force of the agreement in 1994, nor for anticipated actions (the Ecological Decree which was enacted following the Notice of Intent), nor for the actions of non-state actors (e.g., the NGOs and the local community who staged protests). In response to the claim of discriminatory treatment, Mexico argued that Metalclad was not in 'like circumstances' with other investors in the state or municipality; no other hazardous waste landfills existed in the area, in fact the closest thing in the municipality to an 'industrial site' at the time was a gas station.¹¹⁹ Other hazardous waste sites did exist within the country at the time, but because of the environmental liability issues unique to the Guadalcázar landfill and the local opposition to the project, Mexico argued that they were not an appropriate comparator.¹²⁰ Mexico suggested that Metalclad's treatment should only be compared with that of Coterin when it was wholly Mexican-owned. With such a comparison, there was

¹¹⁵*Ibid.*, at para. 253.

¹¹⁶*Ibid.*, at para. 255.

¹¹⁷*Metalclad Counter-Memorial*, at paras. 45-52.

¹¹⁸*Ibid.*, at paras. 77-129.

¹¹⁹*Ibid.*, at para. 814.

¹²⁰*Ibid.*, at para. 813.

clearly no discrimination.¹²¹ Mexico further argued that Metalclad had provided no evidence that it had been forced to provide the state government with information or services, and that even if it had, these did not qualify as performance requirements under Article 1106.

In its discussion of the minimum standard and fair and equitable treatment, Mexico pointed out that the standard should be interpreted in light of the North American Agreement on Environmental Cooperation (NAAEC), a side-agreement of the NAFTA. Among other things the NAAEC acknowledges the rights of states to set high standards for environmental protection, and requires them to enforce their own environmental laws. Mexico further argued that there was no authority on which to base an interpretation of fair and equitable treatment that required transparent and predictable behaviour on the part of the host state.¹²² Furthermore, they argued that no damage had been caused by the demonstration put on by local opponents to the landfill (who were not connected with any level of government in Mexico) and therefore Metalclad's claim that full protection and security had not been provided could not be upheld.¹²³

Finally, with regard to the claim of expropriation, it is worth quoting directly from Mexico's Counter Memorial:

A finding of expropriation on the facts of this case would lead to an unprecedented result. In the Respondent's submission, it would be surprising to all three NAFTA Parties that where a foreign investor sought to make a high risk investment in a highly regulated field, where public opposition to its project was widely known, and the investor knew of both prior to making its investment, a NAFTA Party could be held responsible for that calculated business decision to proceed in the face of known risks.¹²⁴

Both the US and Canada made written submissions to the Tribunal as permitted under Article 1128. Canada cautioned against any equation of the expropriation standard in the NAFTA with the jurisprudence of either the US domestic

¹²¹ *Ibid.*, at paras. 815-6.

¹²² *Ibid.*, at para. 860.

¹²³ *Ibid.*, at paras. 876-9.

¹²⁴ *Ibid.*, at para. 905.

courts or the Iran-US Claims Tribunal.¹²⁵ The US submitted that NAFTA Article 1110's reference to measures 'tantamount' to expropriation addressed both measures that directly and indirectly expropriate, but rejected the suggestion that the term was intended to create a new category of expropriation not previously recognized in customary international law.¹²⁶

Outcome

The Tribunal issued its Award on 30 August 2000. In a very controversial decision, the Tribunal incorporated a provision on transparency from another chapter of the NAFTA into its interpretation of Article 1105 on the minimum standard/fair and equitable treatment.¹²⁷ The Tribunal argued that 'transparency' meant that "all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made ... should be capable of being readily known to all affected investors [of a NAFTA Party]," and that there "should be no room for doubt or uncertainty on such matters."¹²⁸ The tribunal went on to conclude that:

The absence of a clear rule as to the requirement or not of a municipal construction permit, as well as the absence of any established practice or procedure as to the manner of handling applications for a municipal construction permit, amounts to a failure on the part of Mexico to ensure the transparency required by the NAFTA.¹²⁹

This led the Tribunal to the decision that Metalclad had not been treated fairly or equitably.¹³⁰

The Tribunal's determination on expropriation was directly connected to its finding of a breach of Article 1105. The Tribunal argued that in permitting or

¹²⁵ *Metalclad Corporation v. United Mexican States*, ICSID Case No. ARB(AB)/97/1, Submission of the Government of Canada, 28 July 1999, <http://naftaclaims.com>.

¹²⁶ *Metalclad Corporation v. United Mexican States*, ICSID Case No. ARB(AB)/97/1, Submission of the Government of the United States of America (*Metalclad* US Article 1128 Submission), 9 November 1999, <http://www.state.gov>.

¹²⁷ NAFTA, at Art. 102.1.

¹²⁸ *Metalclad* Award, at para. 76.

¹²⁹ *Ibid.*, at para. 88.

¹³⁰ *Ibid.*, at para. 101.

tolerating the conduct of the Municipality of Guadalcázar, Mexico had taken a measure tantamount to expropriation. The Tribunal also relied on the absence of a timely, orderly and substantive basis for the denial of the construction permit by the Municipality in making its assessment that an indirect expropriation had occurred.

The Tribunal determined that consideration of the Ecological Decree was within its jurisdiction but chose not to attach to this particular measure any “controlling importance,” meaning that their finding that the Decree qualified as expropriation did not affect the Award (as the Tribunal had already found that other measures met the standard of expropriation).¹³¹ Despite its irrelevance to the Award itself, the Tribunal made a significant statement that it “*need not decide or consider the motivation or intent* of the adoption of the Ecological Decree” in finding that it constituted a taking. Metalclad was awarded US\$16,685,000.¹³²

Mexico petitioned the Supreme Court of British Columbia (the seat of the arbitration) to annul the Metalclad award on the basis that the Tribunal had acted in excess of jurisdiction by applying transparency provisions as the basis for finding a breach of Article 1105. The Attorney General of Canada intervened to support Mexico’s petition.¹³³

The Court agreed with Mexico and Canada that the Tribunal should not have considered provisions on transparency found in the NAFTA, but outside of Chapter 11, which are subject only to State-State disputes. While Chapter 11 is meant to be interpreted in light of ‘international law’, the Court argued that the proper meaning was customary international law rather than ‘conventional international

¹³¹ *Ibid.*, at para. 69.

¹³² Award, at para. 131.

¹³³ There was a debate over which arbitration act - the International Commercial Arbitration Act (ICAA) or the Commercial Arbitration Act (CAA) - should be applied in the case. This would determine the extent of the legal review possible as under the ICAA only annulment for serious defects in jurisdiction or procedure that damage the integrity of arbitration as an institution is permitted, whereas the CAA also permits judicial review of awards for legal error. The ICAA was adopted by the court, nevertheless, Canada requested that the court review the award with greater scrutiny than was typical for arbitral awards because of the public nature of the dispute and because NAFTA awards did not merit judicial deference. See further Brower 2001b, at 62-3.

law' (i.e. treaties such as the NAFTA).¹³⁴ The Court struck down some aspects of the decision, but concurred with the Tribunal that the actions of Mexico constituted an expropriation and calculated an award of US\$15.6 million. Mexico eventually reached a settlement with Metalclad for an undisclosed amount of compensation.¹³⁵

5.2.3 Tecmed v. Mexico

This case is similar to the *Metalclad* case (it concerns the operation of a hazardous waste facility in Mexico), although it was brought under a BIT rather than the NAFTA. Following the denial for renewal of its operating permit, the Spanish investor in this case argued that Mexico had discriminated against it, had not provided fair and equitable treatment, and had expropriated its investment. The Tribunal found in favour of the investor.

Background

In 1996, an agency in the Municipality of Hermosillo auctioned a hazardous waste landfill located in the State of Sonora, Mexico.¹³⁶ The landfill had been built in 1988. Prior to privatization, the landfill had been run by a municipal government entity, which operated under a licence issued by the Hazardous Materials, Waste and Activities Division of the INE on an indefinite basis.¹³⁷

Tecmed, Técnicas Medioambientales, S.A. de C.V. (Tecmed), a company incorporated under Mexican law and owned by a Spanish parent company, made a successful bid on the site. The company set up a subsidiary, Cytrar, S.A. de C.V., to run the landfill operations. In 1996, Tecmed made a request to the INE for a change in the name on the operating licence to reflect the new ownership

¹³⁴ *United Mexican States v. Metalclad Corporation*, Supreme Court of British Columbia, Reasons for Judgment, 2 May 2001, at para. 62, <http://www.investmentclaims.com>. Reproduced in 5 *ICSID Reports* (2002), at 238.

¹³⁵ González de Cosso 2002, at 236.

¹³⁶ *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award (unofficial English translation from Spanish original) (*Tecmed Award*), 29 May 2003, at para. 35, <http://icsid.worldbank.org>. Reproduced in 19 *ICSID Review* (2004), at 158.

¹³⁷ *Ibid.*, at para. 36.

of the property.¹³⁸ The Municipality of Hermosillo supported this request. However, rather than changing the name on the licence, the INE issued a new licence which, unlike the previous one, was not indefinite and had to be renewed each year. The alteration of permit duration was a part of a general regulatory change implemented by the Mexican government to enable action to be taken against non-compliant landfill sites.¹³⁹

In July 1997, a new Mayor of the Municipality of Hermosillo was elected.¹⁴⁰ Tecmed and the newly elected Mayor faced mounting opposition to the landfill from the local population. On several occasions there were demonstrations and blockades involving several hundred people. In late 1997, the municipal government and the company began negotiations on the relocation of the landfill.¹⁴¹

In December 1997, the association Academia Sonorense de Derechos Humanos (Sonora Human Rights Academy) filed a criminal complaint against Cytrar for the commission of acts that they defined as “environmental crimes.”¹⁴² The main concern with the landfill was its close proximity to the urban centre of Hermosillo (8 km), which was in violation of Mexican regulations requiring hazardous waste to be sited at least 25 km from any settlement of more than ten thousand residents.¹⁴³ However, these regulations were put in place after the landfill had been established, and were not retroactive. Another concern was the transportation of contaminated soil from a plant in Baja California to the landfill.¹⁴⁴ On several occasions inspections conducted by PROFEPA had revealed that there were open hazardous material packaging bags in the trucks transporting the waste.¹⁴⁵ In April 1998, PROFEPA cited further irregularities and levied a fine against the company stating that “there are circumstances that pose or may pose a risk to the environment or to health.”¹⁴⁶ A similar situation occurred in May

¹³⁸ *Ibid.*, at para. 38.

¹³⁹ Newcombe 2007b, at 408.

¹⁴⁰ *Tecmed Award*, at para. 42.

¹⁴¹ *Ibid.*, at para. 110.

¹⁴² *Ibid.*, at para. 108.

¹⁴³ *Ibid.*, at para. 106.

¹⁴⁴ *Ibid.*, at para. 49.

¹⁴⁵ *Ibid.*, at para. 107.

¹⁴⁶ *Ibid.*

1998.¹⁴⁷

In November 1998, the INE released a Resolution denying Cytrar a renewal of its permit and further requesting the company to submit a program for the closure of the landfill. The Resolution based the non-renewal of the permit on the following three grounds: (i) while the company had only been authorized to store agrochemicals and pesticides at the site, it had also been disposing of biological and infectious wastes; (ii) the volume of waste confined at the site far exceeded the limits established for one of the landfill's active cells; and (iii) the landfill had operated as a 'transfer centre' (temporarily storing hazardous waste destined for disposal outside the landfill), an activity for which the company did not have the required authorization.¹⁴⁸ Tecmed argued that these infringements had already been investigated by PROFEPA, which had found that they were not egregious enough to justify the immediate cancellation, suspension or revocation of the permit, and had fined the company instead.¹⁴⁹ After the Resolution was issued, discussions on the possible relocation of the landfill site continued, but they ceased prior to the commencement of arbitration.

The Dispute

On 28 July 2000, Tecmed filed with ICSID an application for approval of access to the Additional Facility and a request for arbitration based on the Agreement on the Reciprocal Promotion and Protection of Investments signed by the Kingdom of Spain and the United Mexican States (Spain-Mexico BIT), which entered into force on 18 December 1996.¹⁵⁰

Tecmed alleged that Mexico had violated the following provisions of the Spain-Mexico BIT: Article 2.1 on the promotion and admission of investments; Article 3 on protection of investments (including full protection and security); Article 4.1 on fair and equitable treatment; Article 4.2 on most-favoured-nation treatment;

¹⁴⁷ *Ibid.*

¹⁴⁸ *Ibid.*, at para. 99.

¹⁴⁹ *Ibid.*, at para. 100.

¹⁵⁰ Agreement on the Reciprocal Promotion and Protection of Investments signed by the Kingdom of Spain and the United Mexican States, 22 June 1995.

Article 4.5 on national treatment; and Article 5 on expropriation.¹⁵¹ The company sought damages, including compensation for harm to its reputation, and additionally requested restitution in kind through the granting of permits to the company to enable it to operate the landfill until the end of its useful life.¹⁵² Tecmed assessed the market value of the landfill at US\$52 million.

Tecmed argued that when it bid on the landfill, it bid not only on the land and tangible materials, but also on intangible assets, most importantly the existing operation permits.¹⁵³ However, the permits that were eventually granted to the company were different (in terms of their duration as well as the conditions to which they were subject) from the permit that was present at the time that the bid was made. Tecmed suggested that, while it was not central to their case, it wished to highlight the permit issue as evidence of a string of actions that amounted to discriminatory treatment.¹⁵⁴ Mexico, for its part, denied that the tender and subsequent award to Tecmed included intangible assets such as licenses or permits, and argued that it was rather solely concerned with certain facilities, land, infrastructure and equipment.¹⁵⁵ Mexico suggested that it was always clear to Tecmed that it would require its own licenses, authorizations or permits in order to operate the landfill. As the bidding had occurred prior to the entry into force of the Spain-Mexico BIT, it was unclear as to whether this issue could be taken into consideration by the Tribunal.¹⁵⁶

However, the central issue for Tecmed was not the limited nature of the permit that Cytrar had been granted, but rather the refusal of the INE to renew it, with no apparent justification. Tecmed argued that the federal government had yielded to the combined pressure of the municipal authorities of Hermosillo and the State of Sonora along with the community movement opposed to the landfill.¹⁵⁷ The company denied any misconduct or violation of the operating permit that could

¹⁵¹ *Tecmed Award*, at para. 93.

¹⁵² *Ibid.*, at para. 184.

¹⁵³ *Ibid.*, at para. 40.

¹⁵⁴ *Ibid.*, at para. 40.

¹⁵⁵ *Ibid.*, at para. 47.

¹⁵⁶ Tecmed sought retroactive application of a treaty on the grounds that absent such application the investor would be receiving less favorable treatment than a similarly situated Austrian investor. The Tribunal noted the claimant's reference to *Maffezini* but refused to consider the Austrian treaty.

¹⁵⁷ *Tecmed Award*, at para. 43.

justify a refusal to renew it.¹⁵⁸ Tecmed argued that it had not received: national treatment, noting that all the previous owners of the landfill - government entities - were provided with operation permits; or most-favoured-nation treatment, pointing out that another foreign investor had been granted an operation permit of unlimited duration for a similar landfill.

Tecmed also claimed that it had not been treated fairly or equitably. Tecmed argued that fair and equitable treatment, “encompasses the duty to act transparently and respecting the legitimate trust generated in the investor.”¹⁵⁹ The company claimed that the Mexican government had not acted transparently (it was not clear that the indefinite permit would be replaced with one of limited duration) and that the ‘legitimate trust’ that had been generated, inducing the company to make the investment in the first place, had been “violated and seriously trampled upon.”¹⁶⁰ Tecmed also alleged that Mexican municipal and state authorities had encouraged the community protests against the Landfill and that the authorities did not act “as quickly, efficiently and thoroughly as they should have to avoid, prevent or put an end to the adverse social demonstrations.”¹⁶¹ The company viewed this as a violation of Article 3.1 of the Spain-Mexico BIT, which provides for full protection and security.

Mexico responded that the INE Resolution was neither arbitrary nor discriminatory and furthermore that it was a “regulatory measure issued in compliance with the State’s police power within the highly regulated and extremely sensitive framework of environmental protection and public health.”¹⁶² Mexico argued that the landfill was denied its permit and shut down for the following reasons: (i) the site of the landfill did not comply with applicable Mexican regulations in terms of its location and characteristics; (ii) in 1998, a number of irregularities occurred in the operation of the landfill, and these irregularities triggered strong community pressure against the landfill; (iii) Mexican authorities, mainly from the Municipality of Hermosillo, expressed their doubts as to the safety of the landfill’s operations; and (iv) there was the risk that community pressure might increase if

¹⁵⁸ *Ibid.*

¹⁵⁹ *Ibid.*, at para. 58.

¹⁶⁰ Memorial, at 122, qtd. in *Tecmed Award*, at para. 58.

¹⁶¹ *Tecmed Award*, at para. 175.

¹⁶² *Ibid.*, at para. 97.

operation of the landfill continued.¹⁶³

Outcome

In 2003, the Tribunal issued its award, finding that Mexico had expropriated Tecmed's investment and had breached the provision on fair and equitable treatment in the Spain-Mexico BIT.

In determining whether or not the INE Resolution constituted an expropriation of Tecmed's investment, the Tribunal adopted a two-part test. In the first part, they assessed whether the company had been "radically deprived of the economical use and enjoyment of its investments, as if the rights related thereto - such as the income or benefits related to the Landfill or to its exploitation - had ceased to exist."¹⁶⁴ The Tribunal suggested that this was:

... one of the main elements to distinguish ... between a regulatory measure, which is an ordinary expression of the exercise of the state's police power that entails a decrease in assets or rights, and a *de facto* expropriation that deprives those assets and rights of any real substance.¹⁶⁵

They went on to suggest that:

... the measures adopted by a State, whether regulatory or not, are an indirect *de facto* expropriation if they are irreversible and permanent and if ... the economic value of the use, enjoyment or disposition of the assets or rights affected by the administrative action or decision have been neutralized or destroyed.¹⁶⁶

Most significantly, they argued that the "government's *intention is less important than the effects of the measures* on the owner of the assets or on the benefits arising from such assets affected by the measures."¹⁶⁷ The Tribunal found that the INE Resolution undoubtedly met the conditions of the effects test.¹⁶⁸

¹⁶³ *Ibid.*, at para. 105.

¹⁶⁴ *Ibid.*, at para. 115.

¹⁶⁵ *Ibid.*

¹⁶⁶ *Ibid.*, at para. 116.

¹⁶⁷ *Ibid.*

¹⁶⁸ *Ibid.*, at para. 117.

However, the Tribunal did not end its discussion of expropriation there, and went on to the second part of its test, on the purpose of the measure. In the Tribunal's view there must be a "reasonable relationship of *proportionality* between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure."¹⁶⁹ In terms of the aim of the expropriatory measure, they determined that the INE Resolution was not designed to protect the environment, but rather issued as a response to the 'political circumstances' surrounding the dispute.¹⁷⁰ The Tribunal noted that:

The absence of any evidence that the operation of the Landfill was a real or potential threat to the environment or to the public health, coupled with the absence of massive opposition, limits 'community pressure' to a series of events, which, although they amount to significant pressure on the Mexican authorities, do not constitute a real crisis or disaster of great proportions, triggered by acts or omissions committed by the foreign investor or its affiliates.¹⁷¹

Thus, they concluded that there was not sufficient justification for Mexico to expropriate Tecmed's property without compensating the company, particularly as it had not been proved that Tecmed's behavior was the cause of the political pressure or the demonstrations.¹⁷² Thus, the Tribunal found that the INE Resolution amounted to a breach of Article 5 of the Spain-Mexico BIT on expropriation.¹⁷³

The Tribunal commenced its evaluation of fair and equitable treatment by noting that 'bad faith' on the part of a state was not required for a breach of this principle.¹⁷⁴ In the Tribunal's view, the provision requires that states provide "treatment that does not affect the *basic expectations* that were taken into account by the foreign investor to make the investment."¹⁷⁵ They went on to note that the foreign investor expects the state to act in a 'consistent manner' and:

¹⁶⁹ *Ibid.*, at para. 122, emphasis added.

¹⁷⁰ *Ibid.*, at para. 127.

¹⁷¹ *Ibid.*, at para. 144.

¹⁷² *Ibid.*, at para. 147.

¹⁷³ *Ibid.*, at para. 151.

¹⁷⁴ *Ibid.*, at para. 153.

¹⁷⁵ *Ibid.*, at para. 154, emphasis added.

... *free from ambiguity and totally transparently* in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations.¹⁷⁶

The Tribunal found that the behavior of the INE conflicted “with what a reasonable and unbiased observer would consider fair and equitable” and thus found Mexico to be in violation of Article 4.1 of the Spain-Mexico BIT.

With regard to Article 3, the Tribunal held that Tecmed had not provided enough evidence to prove that the Mexican authorities encouraged, fostered, supported or participated in the protests against the Landfill.¹⁷⁷ They also found that there was insufficient evidence supporting the allegation that the Mexican authorities did not deal with the protests in an acceptable manner. The Tribunal further noted that the “guarantee of full protection and security is not absolute and does not impose strict liability upon the State that grants it.”¹⁷⁸

The Tribunal also determined that there was insufficient evidence to prove that Tecmed had been discriminated against or had received less favorable treatment than that afforded to nationals or investors of any third State.¹⁷⁹ The Tribunal further decided that Mexico had not breached Article 2.1 (on the promotion and protection of investments), and that if such a violation had occurred, it would be the subject of a state-state dispute rather than an investor-state dispute.¹⁸⁰ Finally, the Tribunal ruled that the INE’s refusal to renew Tecmed’s permit did not amount to a violation of Article 3.2 of the Spain-Mexico BIT, pursuant to which each Contracting Party “within the local legal framework” shall grant the necessary permits with regard to the investments from the other Party.¹⁸¹

¹⁷⁶ *Ibid.*, emphasis added.

¹⁷⁷ *Ibid.*, at para. 176.

¹⁷⁸ *Ibid.*, at para. 177.

¹⁷⁹ *Ibid.*, at para. 181. In particular the Tribunal accepted Mexico’s argument that the circumstances of another foreign investor operating a landfill were materially differed from that of Tecmed and, therefore, could not be compared.

¹⁸⁰ *Ibid.*, at para. 182.

¹⁸¹ *Ibid.* The Tribunal found no evidence showing that INE’s refusal to renew the permit was contrary to Mexican laws.

The Tribunal chose not to consider the option of restitution in kind and rather focused on monetary damages. The Tribunal awarded US\$5,533,017.12 with 6%, compound interest from the date of the expropriatory act (25 November 1998) until the effective and full payment to Tecmed.¹⁸²

5.2.4 S.D. Myers v. Canada

This case revolves around the movement of hazardous wastes across the Canada-US border. Following an opening of the border from the American side, Canada temporarily prohibited the transboundary movement of certain hazardous wastes in order to ensure compliance with its international obligations on the matter. The country was subsequently sued by an American investor for breach of NAFTA Chapter 11 provisions on national treatment, the minimum standard of treatment, performance requirements and expropriation. The UNCITRAL Tribunal found a breach of the former two provisions and awarded the investor compensation.

Background

Polychlorinated biphenyls (PCBs) are highly toxic substances that have been the subject of increasingly strict regulation in Canada and the US since the 1970s. Their production was banned in both countries following a 1973 OECD Council Decision on the issue.¹⁸³ The use of PCBs in products manufactured in or imported into Canada was banned in 1977.¹⁸⁴ In 1986, Canada and the US entered into the Agreement Concerning the Transboundary Movement of Hazardous Waste (Transboundary Agreement), although there was some confusion as to whether this agreement actually covered PCBs, which have never been classified as a hazardous waste in the US (see further below).¹⁸⁵ In 1988, PCBs were included in Schedule 1 on Toxic Substances in the newly developed Canadian

¹⁸² *Ibid* at para. 197.

¹⁸³ *S.D. Myers v. Government of Canada*, Partial Award (*S.D. Myers* Partial Award), 13 November 2000, at para. 99, <http://www.international.gc.ca>. Reproduced in 40 *ILM*, at 1408.

¹⁸⁴ *Ibid.*, at para. 100.

¹⁸⁵ Agreement Concerning the Transboundary Movement of Hazardous Waste, 28 October 1986, Ottawa, <http://www.epa.gov>.

Environmental Protection Act.¹⁸⁶ This legislation was supplemented by the PCB Waste Export Regulations in 1990, which effectively banned the export of PCB waste from Canada to all countries other than the US.¹⁸⁷ Under these regulations, exports to the US were only permitted with the prior approval of the US Environmental Protection Agency (US EPA). In the US, there are restrictions on the manufacture, sale, use, import, export, and disposal of PCBs and PCB contaminated wastes under the Toxic Substances Control Act; however, the US EPA may grant an exemption from this Act if it is satisfied that the applicant's activities will not result in unreasonable risk to human health or the environment.¹⁸⁸

In 1992, Canada ratified the Basel Convention on the Transboundary Movements of Hazardous Wastes.¹⁸⁹ The US also signed the Basel Convention in 1989, but as of early 2008, the country had not yet ratified the agreement. PCBs are listed in Annex 1 of the Basel Convention as "waste to be controlled." Under the Basel Convention, Parties are required, among other things, to:

- reduce the production of hazardous waste;
- ensure the availability of adequate disposal facilities, to the extent possible, within its own boundaries; and
- ensure that the transboundary movement of hazardous wastes and other waste is reduced to the minimum consistent with the environmentally sound and efficient management of such wastes and is conducted in a manner which will protect human health and the environment against the adverse effects which may result from such movement.¹⁹⁰

The export and import of hazardous wastes to and from non-Parties is also prohibited,¹⁹¹ unless an agreement exists between the Party and non-Party that is as stringent as the Basel Convention.¹⁹²

¹⁸⁶ *S.D. Myers* Partial Award, at para. 100.

¹⁸⁷ *Ibid.*

¹⁸⁸ *S.D. Myers, Inc. v. Government of Canada*, Notice of Intent to Submit a Claim to Arbitration (*S.D. Myers* Notice of Intent), 21 July 1998, at 4, <http://www.international.gc.ca>.

¹⁸⁹ Basel Convention on the Transboundary Movements of Hazardous Wastes and their Disposal, 22 March 1989, Basel, <http://www.basel.int/>. Reproduced in 32 *ILM* (1993), at 276.

¹⁹⁰ Basel Convention, at Art. 4.2(a), (b), and (d).

¹⁹¹ *Ibid.*, at Art. 4.5.

¹⁹² *Ibid.*, at Art. 11.

In the early 1990s, S.D. Myers, Inc., an American waste treatment company, began a concerted lobbying effort aimed at acquiring permission from the US EPA to import PCBs and PCB waste from Canada.¹⁹³ Between 1991 and 1993 the company submitted four petitions to the US EPA, who rejected each after finding that S.D. Myers had failed to prove that there was no unreasonable risk to human health or the environment.¹⁹⁴ By the company's own estimates, the proposed importation would expose the US and Canada to the risk of approximately 2.5 PCB spills, including spills of high-concentration PCBs.¹⁹⁵ The US EPA determined that the better alternative was for the PCBs to be destroyed in Canada.

However, S.D. Myers eventually succeeded in its lobbying efforts and received an enforcement discretion valid from 15 November 1995 to 31 December 1997.¹⁹⁶ Under the terms of the enforcement discretion, the US EPA would not enforce the US regulations banning importation of PCBs against S.D. Myers provided that the company met certain conditions. Following this decision, further enforcement discretions were granted to nine other US companies.¹⁹⁷ This turn of events was apparently the result of intense political pressure on the US EPA, brought about as a result of the S.D. Myer's extensive lobbying.¹⁹⁸

In the period that followed the US EPA's decision, the Canadian government struggled with several issues including: (i) whether the enforcement discretion fully complied with US law; (ii) whether exports of PCB wastes to the US, a non-Party to the Basel Convention, would be in compliance with Canada's international commitments; (iii) whether PCBs would be disposed of in the US in an environmentally sound manner; (iv) whether exports would be in compliance with Canada's policy of destroying Canadian PCBs *in Canada*; (v) whether exports would threaten to the long-term viability of domestic PCB disposal facilities; and (vi) whether there would be sufficient options for disposal if US facilities subsequently became unavailable, or if the US border was again closed to im-

¹⁹³*S.D. Myers* Partial Award, at paras. 113-4.

¹⁹⁴Hodges 2002, at 375.

¹⁹⁵*Ibid.*, at 376.

¹⁹⁶*S.D. Myers* Partial Award, at para. 118.

¹⁹⁷*Ibid.*, at para. 119.

¹⁹⁸Hodges 2002, at 378.

ports.¹⁹⁹ In terms of the issue of compliance with the Basel Convention, Canada was unclear as to whether the Transboundary Agreement actually covered PCBs and met the requirements of Article 11. It was not until three months after the US EPA granted the first enforcement discretion that Canada received notification by diplomatic note that the US took the position that the Transboundary Agreement did in fact cover PCBs.²⁰⁰

In November 1995, the Canadian Minister of the Environment signed an Interim Order, which amended the PCB Waste Export Regulations and had the effect of banning the export of PCBs and PCB wastes from Canada. The stated purpose of the Interim Order was “to ensure that Canadian PCB Wastes are managed in an environmentally sound manner in Canada and to prevent any possible significant danger to the environment or to human life or health.”²⁰¹ On 26 February 1996, the Interim Order was converted into a Final Order. It would appear from a memorandum written by the Director of the Hazardous Waste Branch in the Canadian Department of the Environment, that there was concern within the government that this action could be difficult to justify (in particular that the opening of the US border posed a significant danger to the environment or health) and also that it could spark a NAFTA Chapter 11 dispute.²⁰²

In February 1997, having studied the issues and having determined that the country could permit exports of PCBs and still satisfy the requirements of the Basel Convention, Canada re-opened the border by a further amendment to the PCB Waste Export Regulations, allowing exports of PCBs for disposal at US EPA-approved sites. The border was thus closed to cross-border movement of PCBs and PCB waste by regulations introduced by Canada for a period of approximately 16 months, from November 1995 to February 1997.²⁰³ Thereafter, the border was open and there were seven contracts pursuant to which PCBs and PCB waste material were exported from Canada to the US for processing by S.D. Myers.

While these events were transpiring in Canada, across the border the Sierra

¹⁹⁹*S.D. Myers, Inc. v. Government of Canada*, Statement of Defence (*S.D. Myers* Statement of Defence), 18 June 1999, at para. 20, <http://www.international.gc.ca>.

²⁰⁰de Pencier 2000, at 415-6.

²⁰¹Explanatory note attached to the Interim Order, qtd. in *S.D. Myers* Partial Award, at para. 123.

²⁰²Qtd. in Weiler 2001, at 178.

²⁰³*S.D. Myers* Partial Award, at para 127.

Club (an environmental NGO) was challenging the legality of the US EPA enforcement discretion. In July 1997, the Ninth Circuit of the US Court of Appeals overturned the US EPA enforcement discretion, finding that the US EPA had violated its own rule-making procedures and the Toxic Substances Control Act.²⁰⁴ Thus, the border was closed once again from the American side. In total, the border was open to the movement of PCBs and PCB wastes for a period of five months, between February and July 1997.

The Dispute

S.D. Myers filed for NAFTA Chapter 11 arbitration in 1998, claiming US\$20 million in damages.²⁰⁵ S.D. Myers claimed that Canada had breached the following articles of the NAFTA: 1102 on national treatment; 1105 on the minimum standard; 1106 on performance requirements; and 1110 on expropriation.²⁰⁶

In terms of national treatment, S.D. Myers argued that the Interim Order discriminated against US waste disposal operators and favoured domestic companies.²⁰⁷ S.D. Myers put forth that the true purpose of the Interim Order was to favour a Canadian competitor called Chem-Security, which had disposal facilities for PCBs located in the Province of Alberta.²⁰⁸ Canada suggested instead that the export ban merely established a uniform regulatory regime under which all companies were treated equally: neither national nor foreign operators were permitted to export PCBs.²⁰⁹

With regard to the minimum standard, the company claimed that the Interim Order was promulgated in a discriminatory and unfair manner that constituted a

²⁰⁴Hodges 2002, at 379-80.

²⁰⁵*S.D. Myers, Inc. v. Government of Canada*, Notice of Arbitration, 30 October 1998, at 4, <http://www.international.gc.ca>.

²⁰⁶*Ibid.*

²⁰⁷*S.D. Myers, Inc. v. Government of Canada*, Statement of Claim (*S.D. Myers* Statement of Claim), 30 October 1998, at 11, <http://www.international.gc.ca>.

²⁰⁸*S.D. Myers, Inc. v. Government of Canada*, Memorial (*S.D. Myers* Memorial), 20 July 1999, at 9-13, <http://www.international.gc.ca>.

²⁰⁹*S.D. Myers, Inc. v. Government of Canada*, Counter-Memorial (*S.D. Myers* Counter Memorial), 5 October 1999, at 81, <http://www.international.gc.ca>.

denial of justice and a violation of good faith under international law.²¹⁰ In particular, S.D. Myers pointed out that prior to the Interim Order being finalized there had been no consultation with the company or with the US government.²¹¹ Canada rebutted that given the circumstances and the urgent need to respond to the sudden and surprising decision of the US EPA, it had no duty to consult the US government (which had not consulted Canada prior to the US EPA decision) let alone a company that it argued it was unaware of.²¹² In any case, non-consultation would not amount to the kind of egregious behaviour required to breach the minimum standard, in the view of Canada.²¹³

In terms of performance requirements, S.D. Myers claimed that the Interim Order effectively required it to dispose of PCB contaminated waste in Canada.²¹⁴ The company argued that this resulted in a performance requirement for PCB disposal operators to accord preference to Canadian goods and services and to achieve a given level of domestic content.²¹⁵ Canada refuted this and pointed out that the NAFTA lists all prohibited performance requirements and export bans are not so-listed. Furthermore, Canada argued that even if the Interim Order were classified as a prohibited performance requirement, the exception would apply because it is a measure necessary to protect human, animal or plant life or health or was necessary for the conservation of living or non-living exhaustible natural resource. The argument that the Interim Order was intended to protect the environment was challenged by S.D. Myers, who pointed to the fact that the majority of the PCB waste in Canada was located in Ontario and Quebec, making S.D. Myers facilities in Ohio significantly closer than those of Chem-Security in Alberta.²¹⁶ Assuming that the facilities in Alberta and Ohio were comparable (as S.D. Myers claimed), one would conclude that cross-border shipment was the more environmentally-sound option. However, as S.D. Myers reportedly planned to recycle the wastes in Ohio, but then ship them to Texas for final incineration,

²¹⁰ *S.D. Myers Memorial*, at 51-7.

²¹¹ *Ibid.*

²¹² *S.D. Myers Counter-Memorial*, at 89-90; de Pencier 2000, at 411-2.

²¹³ *Ibid.*, at 88.

²¹⁴ *S.D. Myers Memorial*, at 62-6.

²¹⁵ *Ibid.*

²¹⁶ *Ibid.*, at 6.

the distances for the movement of the wastes were actually much greater.²¹⁷

With respect to its final claim, S.D. Myers put forth that Canada had indirectly expropriated its investment without providing compensation.²¹⁸ Canada repudiated this claim, pointing to the fact that S.D. Myers subsidiary in Canada had continued operations while the Interim Order remained in effect and that there was no evidence that S.D. Myers had sustained any loss as a result of the Interim Order.²¹⁹

In addition to rebutting S.D. Myers' claims, Canada also argued that the Interim Order was not a measure that 'related to' an investor or an investment in Canada (as required for Chapter 11 to apply), and suggested that S.D. Myers did not in fact have an investment in Canada, as the shares of Myers Canada were owned by several members of the Myers family, rather than by S.D. Myers as a company.²²⁰ Furthermore, Canada contended (as did Mexico in a Non-Party submission) that because S.D. Myers and Myers Canada were engaged in the trade in goods or cross-border services, Chapters 3 and 12 of the NAFTA applied, which take precedence over Chapter 11.²²¹ Canada further argued that its other international obligations, including the Basel Convention and Transboundary Agreement, should prevail over Chapter 11 obligations in the event of any inconsistency.²²² Finally, Canada sought to establish that the US EPA Enforcement Discretion, which had provided the basis for the open border and thus the Interim Order and the NAFTA dispute, had not been lawful.²²³

Outcome

On 13 November 2000, the Tribunal delivered its First Partial Award. Although the Tribunal was unanimous in its findings, one arbitrator also wrote a Separate

²¹⁷Hodges 2002, at 383.

²¹⁸*S.D. Myers* Memorial, at 74-5.

²¹⁹*S.D. Myers* Counter-Memorial, at 105.

²²⁰*Ibid.*, at 66-76.

²²¹*Ibid.*, at 122; *S.D. Myers v. Canada*, Article 1128 Submission of Mexico on the Merits, 14 January 2000, <http://www.naftaclaims.com>.

²²²*Ibid.*, at 61-3.

²²³*S.D. Myers* Partial Award, at para. 191.

Concurring Opinion.²²⁴

The Tribunal found that S.D. Myers was an ‘investor’ and had an ‘investment’ under the definitions provided in Chapter 11, despite the previously mentioned issue of share ownership.²²⁵ They also found that the requirement that the import ban relate to S.D. Myers and its investment in Canada was easily satisfied, arguing that the company’s plans to expand its Canadian operations was the specific inspiration for the Interim and Final Orders.²²⁶ The Tribunal determined that Canada had breached Articles 1102 and 1105 (on national treatment and the minimum standard respectively).²²⁷ They did not find that Canada had used a prohibited performance requirement or that it had expropriated S.D. Myers’ investment.²²⁸ In arriving at its decision, the Tribunal found that the evidence presented by S.D. Myers established that the Interim and Final Orders were designed to a great extent with the “desire and intent to protect and promote the market share of enterprises that would carry out the destruction of PCBs in Canada and that were owned by Canadian nationals.”²²⁹ They argued that while other factors were considered, the “protectionist intent of lead minister ... was reflected in decision-making at every stage that led to the ban.”²³⁰

In terms of the environmental justification for the measures, the Tribunal found “no legitimate environmental reason for introducing the ban.”²³¹ The Tribunal suggested that the “indirect environmental objective” of ensuring continued domestic capacity to dispose of PCBs and PCB wastes was legitimate but “could have been achieved by other measures” (e.g., sourcing all government requirements, granting subsidies to the Canadian industry, etc.).²³² As for the Basel Con-

²²⁴ Under the UNCITRAL Rules (31 and 32) there can only be one award of the Tribunal on any particular issue, and therefore a separate opinion is technically not part of an award and has no legal status.

²²⁵ *S.D. Myers* Partial Award, at paras. 320-1.

²²⁶ *Ibid.*, at para. 234.

²²⁷ *Ibid.*, at para. 322.

²²⁸ *Ibid.*, at para. 323.

²²⁹ *Ibid.*, at para. 162.

²³⁰ *Ibid.*

²³¹ *Ibid.*, at para. 195.

²³² *Ibid.* Orellana 2007, at 769, argues that it is highly debatable whether these alternatives would have been as (cost) effective as the Interim/Final Order, and furthermore suggests that they likely would

vention, the Tribunal first of all determined that Article 11 clearly permitted the continuation of the Transboundary Agreement, which allowed for cross-border movements of hazardous waste between Canada and the US. However, they also noted that, “[e]ven if the Basel Convention were to have been ratified by NAFTA Parties, *it should not be presumed that Canada would have been able to use it to justify the breach of a specific NAFTA provision.*”²³³ Thus the Tribunal concluded that “where a state can achieve its chosen level of environmental protection through a variety of equally effective and reasonable means, it is obliged to adopt the alternative that is *most consistent with open trade.*”²³⁴ The Tribunal chose not to look into the issue of the legality of the US EPA enforcement discretion, arguing that Canada had never challenged the measure directly, and did eventually re-open the border (thus implicitly accepting the legality of the situation).²³⁵

In considering whether Canada had breached its commitment to provide national treatment, the Tribunal looked at the broader legal context in which Article 1102 is situated, including: the rest of the NAFTA; the NAAEC; and principles that are affirmed by the NAAEC (including the Rio Declaration principles). The principles that the Tribunal focused on were the following:

- States have the right to establish high levels of environmental protection and they are not obliged to compromise their standards merely to satisfy the political or economic interests of other states;
- States should avoid creating distortions to trade; and
- Environmental protection and economic development can and should be mutually supportive.²³⁶

The Tribunal appeared to focus quite extensively on the interpretation of the phrase ‘like circumstances’ in respect of these principles. The Tribunal suggested that

Article 1102 must take into account the general principles that emerge from the legal context of NAFTA, including both its concern with the environ-

have violated the WTO Government Procurement Agreement or the WTO Subsidies Agreement.

²³³ *S.D. Myers* Partial Award, at para. 215, emphasis added.

²³⁴ *Ibid.*, at para. 221, emphasis added.

²³⁵ *Ibid.*, at para. 191.

²³⁶ *Ibid.*, at para. 220.

ment and the need to avoid trade distortions that are not justified by environmental concerns. The assessment of 'like circumstances' must also take into account circumstances that would justify governmental regulations that treat them differently in order to protect the public interest.²³⁷

After establishing that S.D. Myers was in 'like circumstances' with Canadian competitors, the Tribunal further assessed two factors: whether the practical effect of the measure is to create a disproportionate benefit for nationals over non-nationals; and whether the measure, on its face, appears to favour its nationals over non-nationals who are protected by the relevant treaty.²³⁸ The Tribunal concluded on the basis of its assessment that the issuance of the Interim Order and the Final Order was in breach of Article 1102 of the NAFTA.²³⁹

The Tribunal commenced its argument on the minimum standard with a precautionary statement that a tribunal "does not have an open-ended mandate to second-guess government decision-making."²⁴⁰ They then went on to acknowledge that:

Governments have to make many potentially controversial choices. In doing so, they may appear to have made mistakes, to have misjudged the facts, proceeded on the basis of a misguided economic or sociological theory, placed too much emphasis on some social values over others and adopted solutions that are ultimately ineffective or counterproductive. The ordinary remedy, if there were one, for errors in modern governments is through internal political and legal processes, including elections.²⁴¹

The Tribunal thus appeared to be somewhat sympathetic to the position of states and further held that breach of fair and equitable treatment, as an integral part of the minimum standard, requires conduct that is so unjust or arbitrary that it can be deemed unacceptable from the international perspective, noting that "determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within

²³⁷*Ibid.*, at para. 250.

²³⁸*Ibid.*, at para. 252.

²³⁹*Ibid.*, at para. 256.

²⁴⁰*Ibid.*, at para. 261.

²⁴¹*Ibid.*

their own borders.”²⁴² It is somewhat surprising that the Tribunal followed these statements with its determination (by majority) that “the breach of Article 1102 essentially establishes a breach of Article 1105 as well.”²⁴³ This decision would later be rebuked by all the NAFTA Parties in an Interpretation of Article 1105 released by the NAFTA FTC.²⁴⁴

The Tribunal agreed, by majority, with Canada that the Interim and Final Orders did not qualify as prohibited performance requirements under Article 1106.²⁴⁵ The Tribunal also rejected the interpretation provided by S.D. Myers that the phrase “tantamount to expropriation” expanded the meaning of Article 1110 beyond the accepted definition in international law.²⁴⁶ The Tribunal argued that ‘tantamount’ meant ‘equivalent to’.²⁴⁷ The Tribunal categorized the Interim Order and the Final Order as “regulatory acts,” noting the distinction between expropriations, which “tend to involve the deprivation of ownership rights,” and regulations, which are a “lesser interference.”²⁴⁸ They went on to note that “[r]egulatory conduct by public authorities is unlikely to be the subject of legitimate complaint under Article 1110 of NAFTA, although the Tribunal does not rule out that possibility.”²⁴⁹ However, the Tribunal then proceeded to draw a different distinction, between permanent and temporary interferences in an investment. The fact that the closure of the Canadian border was temporary appears to have strongly influenced the Tribunal’s decision that it did not amount to an expropriation:

In this case, the Interim Order and the Final Order were designed to, and did, curb [S.D. Myers’s] initiative, *but only for a time*. CANADA realized no benefit from the measure. The evidence does not support a transfer of

²⁴² *Ibid.*, at para. 263.

²⁴³ *Ibid.*, at para. 266.

²⁴⁴ Paragraph B.3 of the interpretation states: “A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).”

²⁴⁵ *S.D. Myers* Partial Award, at para. 278. One arbitrator dissented, finding that the effect of the Orders was to require S.D. Myers to undertake all of its operations in Canada which amounted to a prohibited performance requirement.

²⁴⁶ *Ibid.*, at para. 285.

²⁴⁷ *Ibid.*, at para. 286.

²⁴⁸ *Ibid.*, at para. 282.

²⁴⁹ *Ibid.*, at para. 281.

property or benefit directly to others. *An opportunity was delayed.*²⁵⁰

With regard to the issue of compensation, the Tribunal noted that, except in the case of Article 1110 on expropriation, the NAFTA does not stipulate any particular methodology for the calculation of damages. They thus concluded that the drafters of the NAFTA had intended for arbitrators to decide on an appropriate method, in light of the specific circumstances of a given case.²⁵¹ In this case, the Tribunal decided that the application of the ‘fair market value’ standard was “not a logical, appropriate or practicable measure of the compensation to be awarded.”²⁵² The Tribunal also agreed with Canada that: the burden is on the Claimant to prove the quantum of the losses in respect of which it puts forward its claims; compensation is payable only in respect of harm that is proved to have a sufficient causal link with the specific NAFTA provision that has been breached (the economic losses claimed must be proved to be those that have arisen from a breach of the NAFTA, and not from other causes); and damages for breach of any one NAFTA provision should take into account any damages already awarded under a breach of another NAFTA provision.²⁵³ The Tribunal delayed the final decision on compensation to the Second Partial Award, where it concluded that the total compensation payable to S.D. Myers was CDN\$6,050,000 plus compound interest.²⁵⁴ The Final Award concerned the apportionment of legal fees and arbitration costs. Canada was required to pay CDN\$850,000 plus compound interest in costs and fees.²⁵⁵

Canada sought judicial review of the Tribunal’s First Partial Award in the Federal Courts of Canada (the arbitration had its seat in Toronto). Canada argued that the Tribunal had exceeded its jurisdiction by deciding on a case in which no investment was involved and had incorrectly determined that S.D. Myers was in ‘like circumstances’ with Canadian waste disposal companies. Canada also ar-

²⁵⁰ *Ibid.*, at para. 287, emphasis added.

²⁵¹ *Ibid.*, at para. 309.

²⁵² *Ibid.*

²⁵³ *Ibid.*, at para. 316.

²⁵⁴ *S.D. Myers, Inc. v. Government of Canada*, Second Partial Award, 21 October 2002, at paras. 311-2, <http://www.international.gc.ca>.

²⁵⁵ *S.D. Myers, Inc. v. Government of Canada*, Final Award, 30 December 2002, at paras. 53-5, <http://www.international.gc.ca>.

gued that the First Partial Award violated the country's public policy.²⁵⁶ The Court issued its judgment in January 2004, noting the limited scope of judicial review of tribunal awards and dismissing the case.²⁵⁷ Of particular interest is the court's decision that review on the basis of conflicts with public policy is limited to cases of flagrant injustice, rather than mere conflicts with a government's 'political position'.²⁵⁸

5.2.5 Methanex v. United States

This case revolves around the production and sale of a gasoline additive in California. Following a university study that concluded that the additive was a significant source of potential water pollution and a threat to public health, the State of California phased out its use. A Canadian investor subsequently sued the US under Chapter 11 of the NAFTA for expropriation and breach of the national and minimum standards of treatment. The Tribunal in the case dismissed all claims and determined that the claimant should pay all of the costs and legal fees incurred in the course of the arbitration.

Background

Beginning in the late 1980s, studies were undertaken in the US to identify ways in which gasoline could be reformulated to help achieve certain air quality goals.²⁵⁹ These studies found that the addition of oxygenated organic compounds, such as alcohols and ethers, to conventional gasoline resulted in a reduction in the emissions of carbon monoxide and other products of incomplete combustion.²⁶⁰ The use of oxygenates in fuel subsequently became mandatory under US Federal law. In California, the 'oxygenate of choice' was methyl tertiary-butyl ether (MTBE). Thus, MTBE was initially brought into use in California (and other locations) to

²⁵⁶ Brower 2004, at 342.

²⁵⁷ *Attorney General of Canada v. S.D. Myers, Inc.*, 3 *Federal Court Reports* (2004), at 368, <http://reports.fja.gc.ca>.

²⁵⁸ *Ibid.*, at para. 55.

²⁵⁹ *Methanex Corporation v. United States of America*, Final Award, 9 August 2005, at para. III.A.4., <http://www.state.gov>. Reproduced in 44 *ILM* (2005), at 1345.

²⁶⁰ *Ibid.*

bring about health and environmental benefits. However, improvements in the emission control technology used in newer cars have significantly reduced emissions of air pollutants and as a result, MTBE and other oxygenates no longer have significant effects on air quality.²⁶¹ On the other hand, they do pose environmental risks associated with groundwater contamination. MTBE is highly soluble in water and will transfer readily to groundwater from gasoline leaking from underground storage tanks, pipelines and other components of the gasoline distribution system.²⁶²

On 9 October 1997, the California Senate adopted Bill 521, which commissioned an assessment of the human health and environmental risks and benefits associated with the use of MTBE and other gasoline oxygenates, to be carried out by researchers at the University of California.²⁶³ In 1998, the University of California released its five-volume, 600 page, report (the UC Report).²⁶⁴ The UC Report concluded that California's water resources were being placed at risk by the use of MTBE in gasoline. While the UC Report suggested that the risk of exposure to MTBE through ingestion or inhalation was low, they noted that there were significant gaps in the scientific understanding of the acute and chronic toxicity of MTBE.²⁶⁵ The UC Report also suggested that the potential treatment costs of MTBE-contaminated drinking water could be enormous. Furthermore, the costs associated with fixing all the leaking underground storage tanks and pipelines would be in the order of tens of hundreds of millions of dollars per year.²⁶⁶

The UC Report recommended that California phase-out the use of gasoline oxygenates. In order to do so, it would have to seek a waiver from the Federal Government requirements on the use of oxygenates in fuel. A second-best option, suggested in the UC Report, was the use of ethanol as an oxygenate to replace

²⁶¹ "University of California Report MTBE Fact Sheet", *UC Davis website*, 12 November 1998, at 1, <http://tsrtp.ucdavis.edu/public/mtbe/mtberpt/index.php>.

²⁶² *Ibid.*

²⁶³ *Methanex Corporation v. United States of America*, First Partial Award (*Methanex* First Partial Award), 7 August 2002, at para. 26, <http://www.state.gov/>.

²⁶⁴ Health & Environmental Assessment of MTBE, Report to the Governor and Legislature of the State of California, Volume I, Summary & Recommendations, November 1998, <https://tsrtp.ucdavis.edu/public/mtbe/mtberpt/vol1.pdf>.

²⁶⁵ *Ibid.*, at 12.

²⁶⁶ *Ibid.*

MTBE. The inadequate supply of ethanol in the state meant that an immediate ban on MTBE would have negative implications for consumers and disrupt gasoline production significantly, and the UC Report therefore recommended a scheduled phase-out, coupled with a careful study of the environmental and health impacts of alternative oxygenates, such as ethanol.²⁶⁷

In response to the UC Report, then Governor of California, Gray Davis, issued Executive Order D-5-99 on 25 March 1999.²⁶⁸ The Order directed the relevant government bodies to: develop a timetable for the phase out of MTBE; request from the US EPA a waiver of the Federal Government reformulated gasoline oxygenate requirement; and conduct a study on the environmental and health impacts associated with the use of ethanol as an oxygenate in gasoline. Furthermore, the Governor commissioned a study on the potential for the development of a California waste-based or other biomass ethanol industry and required that gasoline containing MTBE be labeled prominently at the point of sale (gas stations) to enable consumers to choose the type of gasoline that they wished to purchase.²⁶⁹

On 12 April 1999, Governor Davis wrote to the Administrator of the US EPA requesting a waiver from the reformulated gasoline oxygenate requirement. On 8 October 1999, Governor Davis signed into law California Senate Bill 989 placing into statute the previously issued Executive Order (D-5-99) and enacting several other provisions designed to protect groundwater and drinking water from MTBE contamination.²⁷⁰ In December 1999, the California EPA issued its report, entitled Health and Environmental Assessment of the Use of Ethanol as a Fuel Oxygenate.²⁷¹ Based on the report, the California Environment Policy Commission concluded that, although further research was warranted, the impacts associated with the use of ethanol would be significantly less, and that these impacts would also be more manageable, than those associated with continued use of MTBE.²⁷²

²⁶⁷ *Ibid.*, at 13-4.

²⁶⁸ *Methanex* First Partial Award, at para. 29.

²⁶⁹ *Ibid.*, at paras. 30-1.

²⁷⁰ *Ibid.*, at para. III.A.29.

²⁷¹ Health and Environmental Assessment of the Use of Ethanol as a Fuel Oxygenate, Report to the California Environmental Policy Council in Response to Executive Order D-5-99 State Water Resources Control Board of California, Air Resources Board, Office of Environmental Health and Hazard Assessment, UCRL-AR-135949 Vol. 1, <http://www-erd.llnl.gov/ethanol/etohdoc/index.html>.

²⁷² *Methanex* Final Award, at para. III.A.31.

On 16 June 2000, the California Reformulated Gasoline Phase III Standards (CaRFG3), which prohibited the use of MTBE in gasoline beginning 31 December 2002, were adopted.²⁷³ These regulations became effective on 2 September 2000, and were amended in 2001. The phase-out date was later postponed in response to the US EPA's denial of California's request for a waiver of the federal oxygenate requirement. Governor Davis felt that in light of the circumstances, in particular the fact that the current production, transportation and distribution of ethanol was insufficient to meet the California's needs, keeping to the original timetable would cause economic hardship.²⁷⁴

The Dispute

In December 1999, Methanex Corporation, a Canadian company that produces and markets methanol, served a Notice of Arbitration against the US under Chapter 11 of the NAFTA and the UNCITRAL Rules of Arbitration.²⁷⁵ Methanex supplies the vast majority of methanol in California, which has no methanol industry of its own.²⁷⁶ While Methanex does not produce or sell MTBE, approximately one third of Methanex's methanol production at the time was directed at the fuel sector, principally for use in the production of MTBE.²⁷⁷

Subsequent to submitting its Statement of Claim,²⁷⁸ the company changed its legal counsel and applied to the Tribunal to amend the claim. Methanex's application substantially modified the legal and factual basis of its claim, and was apparently based on new information related to Governor Gray Davis (see below).²⁷⁹ The Tribunal allowed the amendment, with the caveat that Methanex

²⁷³ *Ibid.*, at para. III.A.32.

²⁷⁴ *Ibid.*, at para. III.A.34.

²⁷⁵ *Methanex Corporation v. United States of America*, Notice of Arbitration, 3 December 1999, <http://www.state.gov>.

²⁷⁶ *Methanex Corporation v. United States of America*, Rejoinder to US' Reply Memorial on Jurisdiction, Admissibility and the Proposed Amendment, 25 May 2001, at 27, <http://www.state.gov>.

²⁷⁷ *Methanex First Partial Award*, at para. 24.

²⁷⁸ *Methanex Corporation v. United States of America*, Statement of Claim (*Methanex Original Statement of Claim*), 3 December 1999, <http://www.state.gov>.

²⁷⁹ *Methanex Corporation v. United States of America*, Notice of Change of Legal Council and Intent to File an Amended Claim, 30 November 2000, <http://www.state.gov>.

should ultimately bear, regardless of the outcome of the arbitration, the costs related to the additional burden on the Tribunal and the US in having to respond to the amendments to the claim.²⁸⁰ Methanex submitted its Amended Statement of Claim in February 2001.²⁸¹

In the Original Statement of Claim, Methanex argued that: the State of California did not accord a minimum standard of treatment as required by Article 1105; and various actions taken by the State of California and its Governor directly or indirectly constituted a measure tantamount to expropriation under Article 1110. Methanex claimed compensation from the US in the amount of approximately US\$970 million (together with interest and costs).²⁸² In the Amended Statement of Claim, the company focused only on the California Executive Order and the CaRFG3 Regulations, and not the California Senate Bill.²⁸³ Methanex added a new claim of discrimination on the basis of nationality as prohibited by Article 1102, as well as further claims for breaches of Articles 1105 and 1110.²⁸⁴

In its Statement of Defence, the US raised a series of objections to jurisdiction and admissibility in respect of Methanex's Claims.²⁸⁵ The Tribunal identified 7 distinct challenges articulated by the US Government: no proximate cause (no connection between US measures and claimed damages); no legal right impugned by US measures (customer base or goodwill or expectation of future profits from methanol sales cannot qualify as an investment under the NAFTA); no legally significant connection between US measures and Methanex or its investments; no loss; no claim for subsidiaries' losses (a procedural issue); no waiver (a procedural issue); and no possible claim of discrimination (all methanol producers were treated the same, regardless of corporate nationality).²⁸⁶ The third challenge is particularly worth discussion. This challenge related to Article 1101.1 of the NAFTA, which requires that challenged measures *relate to* an investor or

²⁸⁰ *Methanex* First Partial Award, at para. 78.

²⁸¹ *Methanex Corporation v. United States of America*, Amended Statement of Claim (*Methanex* Amended Statement of Claim), 12 February 2001, <http://www.state.gov>.

²⁸² *Methanex* Original Statement of Claim, at 13.

²⁸³ *Methanex* Amended Statement of Claim, at 35.

²⁸⁴ *Ibid.*, at 42-70.

²⁸⁵ *Methanex Corporation v. United States of America*, Statement of Defense (*Methanex* Statement of Defense), 10 August 2000, <http://www.state.gov>.

²⁸⁶ *Methanex* First Partial Award, at para. 84.

investment. The US asserted that the Californian ban of MTBE did not relate to Methanex because it was not directed at methanol or methanol producers. The US contended that the phrase ‘relating to’ requires a *legally significant* connection between the disputed measure and the investor.²⁸⁷ This excludes measures of general application, especially measures aimed at the protection of human health and the environment, which are likely to affect a vast range of actors and economic interests. The US argued that if such general measures were not excluded from consideration by tribunals, the Parties to the NAFTA could be subject to claims based on untold numbers of local, state and federal measures that merely have an incidental impact on an investor or investment.²⁸⁸ Methanex, on the other hand, contended that it is sufficient that the measures *affect* the investor or its investment.²⁸⁹ Furthermore, it argued that the ‘relating to’ requirement is easily satisfied if there is discriminatory intent behind a measure.²⁹⁰

In its First Partial Award, the Tribunal found that several of the US challenges were not *jurisdictional* challenges and that, even if they were, the issues were so tied up in the facts of the case that they would have to be dealt with in the merits phase of arbitration. However, the Tribunal did extensively discuss the third challenge, concerning the connection required between a measure and an investment. The Tribunal noted that:

If the threshold provided by Article 1101(1) were merely one of ‘affecting,’ as Methanex contends, it would be satisfied wherever any economic impact was felt by an investor or an investment ... As such, Article 1101(1) would provide no significant threshold to a NAFTA arbitration ... Methanex’s interpretation would produce a surprising, if not an absurd, result. The possible consequences of human conduct are infinite, especially when comprising acts of governmental agencies; but common sense does not require that line to run unbroken towards an endless horizon.²⁹¹

²⁸⁷ *Methanex* Statement of Defense, at 28.

²⁸⁸ *Methanex Corporation v. United States of America*, US Memorial on Jurisdiction, 13 November 2000, at 48-9, <http://www.state.gov>.

²⁸⁹ *Methanex Corporation v. United States of America*, Counter-Memorial on Jurisdiction, 12 February 2001, at 47-8, <http://www.state.gov>.

²⁹⁰ *Ibid.*, at 51-2.

²⁹¹ *Methanex* First Partial Award, at para. 137.

As such, the Tribunal determined that it had no jurisdiction to hear Methanex's case as laid out in the Original Statement of Claim. Similarly, it denied jurisdiction on the Amended Statement of Claim *as a whole*, but found that it had jurisdiction to hear *a part of that claim*. In particular, the Tribunal found that Methanex's allegations relating to the *intent* underlying the Californian regulations could potentially meet the requirements of jurisdiction, but that without further evidence, this could not be definitively determined. Methanex was therefore invited to submit a fresh pleading setting out its specific factual allegations related only to the issue of intent, and the decision on jurisdiction was consequently postponed pending the conclusion of the merits phase of the arbitration.²⁹² Methanex sought interpretation, clarification and reconsideration of the First Partial Award on two occasions.²⁹³ The Tribunal clarified its position, but declined to reconsider any aspect of the First Partial Award, which it viewed as final and binding on the parties.²⁹⁴ Methanex submitted a Second Amended Statement of Claim in November 2002.²⁹⁵

In order to support its claims of breach of national treatment, which were largely based on the notion that US measures were intended to favour the domestic ethanol industry, Methanex first had to establish that it was in 'like circumstances' with ethanol producers. The company's reasoning on this issue was based on the fact that ethanol, as an oxygenate, competes directly with MTBE. Methanex supported this claim with the expert opinion of Sir Robert Jennings and reference to WTO jurisprudence on the treatment of 'like products'.²⁹⁶ While it was not contested amongst the parties to the dispute that methanol is the essential oxygenating element of MTBE, Methanex also relied on the fact that methanol can be used directly as a fuel oxygenate, and was therefore interchangeable with ethanol.²⁹⁷ The

²⁹² *Ibid.*, at paras. 169 and 172.

²⁹³ *Methanex Corporation v. United States of America*, Request for Interpretation of Award, 28 August 2002; Request for Reconsideration of Chapters J and K of the Partial Award, 28 January 2004, <http://www.state.gov>.

²⁹⁴ Letter from the Tribunal, Re: Request for Interpretation of the First Partial Award, 25 September 2002, <http://www.state.gov>.

²⁹⁵ *Methanex Corporation v. United States of America*, Second Amended Statement of Claim (*Methanex Second Amended Statement of Claim*), 5 November 2002, <http://www.state.gov>.

²⁹⁶ *Ibid.*, at para 300.

²⁹⁷ *Ibid.*, at para 70.

US countered that methanol was not a legal fuel oxygenate in California.

Methanex contended that the burden of proof was on the US to justify its discriminatory treatment. It argued that under WTO jurisprudence, this would require the US to show that the ban on MTBE was: necessary to protect the environment of California; the least restrictive option available; based on sufficient scientific evidence; and not arbitrary or discriminatory.²⁹⁸ Methanex suggested that none of these requirements had been met. In the company's view, MTBE is safe and effective and any environmental problems associated with it are principally caused by leaking underground gasoline tanks. Consequently, according to Methanex, the appropriate solution was not to ban MTBE, but to repair and improve storage tanks.²⁹⁹ Methanex further argued that, in any case, the MTBE ban was not motivated by the Government of California's desire to protect the environment. The company claimed that environmental protection was merely a convenient cover for measures that would significantly benefit the powerful US ethanol industry. In this respect, Methanex focused on one company in particular, Archer Daniels Midland (ADM), which produces more than 70% of US ethanol. Methanex pointed to several contributions that ADM made to Gray Davis' gubernatorial campaign and to a supposedly secret meeting with Davis in 1998, when he was Lieutenant Governor of California and the California MTBE policy was being developed.

Whereas Methanex's discussion of the discriminatory treatment that it had allegedly endured was quite extensive, its discussion of the minimum standard and expropriation were remarkably short, occupying only a few paragraphs each in the Second Amended Statement of Claim. This is likely due to the fact that Methanex viewed discrimination as intimately connected to the other standards. Methanex argued that a breach of Article 1102 also constituted a breach of Article 1105, citing the decision in *S.D. Myers* (see above).³⁰⁰ In terms of expropriation, Methanex argued that a substantial portion of its investments, including its share of the California and wider US oxygenate markets, was taken by a discriminatory measure and handed to the US domestic ethanol industry. The company argued

²⁹⁸ *Methanex Corporation v. United States of America*, Reply to US Amended Statement of Defense, 19 February 2004, at paras. 191-5, <http://www.state.gov>.

²⁹⁹ *Methanex* Second Amended Statement of Claim, at para 199.

³⁰⁰ *Methanex* Second Amended Statement of Claim, at para. 315.

that none of the conditions for a legal expropriation had been met: the taking was discriminatory; the taking was not for public purpose; the taking did not comply with due process (because it was discriminatory); and compensation had not been provided.³⁰¹ In addition to having lost its share of the California market, Methanex claimed that the measures contributed to the continued idling of one of their plants in the US and resulted in an immediate drop in their share price.³⁰²

On the merits of Methanex's claim, the US argued that not only was there no evidence of a breach of any NAFTA article, but Methanex had also failed to establish that the damages it claimed were actually caused by the Californian ban.³⁰³ In fact they disputed that Methanex had suffered any quantifiable loss at all.

In terms of Article 1102, the US argued that the appropriate comparator in the 'like circumstances' test was the substantial domestic methanol industry. As the California ban had precisely the same effect on American methanol companies as it had on Methanex, there could be no breach of national treatment. The US rejected Methanex's method of comparing methanol and ethanol, pointing out that they were different in several respects, and specifically that while ethanol can be used directly as an oxygenate additive to gasoline, methanol is prohibited from being used as such.³⁰⁴ Methanex countered that the fact that they were in identical circumstances with domestic methanol producers was irrelevant.³⁰⁵

The US also challenged the allegations that the measures were not motivated by environmental concern, pointing out that the decision to ban MTBE was firmly based on the recommendations and findings of an extensive scientific study and consultation with stakeholders.³⁰⁶ The US argued that:

Methanex's claim *does not remotely resemble* the type of grievance for which the States Parties to NAFTA created the investor-State dispute resolution mechanism of Chapter 11. Methanex's case is founded on the propo-

³⁰¹ *Ibid.*, at paras. 317-20.

³⁰² *Methanex* Final Award, at para. II.D.31.

³⁰³ *Methanex Corporation v. United States of America*, Amended Statement of Defence (*Methanex* Amended Statement of Defense), 5 December 2003, at paras. 216-280, <http://www.state.gov>.

³⁰⁴ *Ibid.*, at paras 315-6.

³⁰⁵ *Methanex Corporation v. United States of America*, Reply to the Amended Statement of Defense, 19 February 2004, at para 173, <http://www.state.gov>.

³⁰⁶ *Methanex* Amended Statement of Defense, at paras 190-206.

sition that, whenever a State takes action to protect the public health or environment, the State is responsible for damages to every business enterprise claiming a resultant setback in its fortunes if the enterprise can persuade an arbitral tribunal that the action could have been handled differently. Plainly put, this proposition is absurd. If accepted by this Tribunal, *no NAFTA Party could carry out its most fundamental governmental functions unless it were prepared to pay for each and every economic impact occasioned by doing so*. The NAFTA Parties *never intended* the NAFTA to bring about such a radical change in the way that they function, and Methanex cannot show otherwise.³⁰⁷

In 2001, the US submitted a copy of the Notes of Interpretation issued by the NAFTA FTC to the Tribunal. The Interpretation clarified that Article 1105 did not require treatment beyond that prescribed in customary international law and stipulated that the determination that there has been a breach of another provision of the NAFTA did not establish a breach of Article 1105. Methanex challenged the Interpretation, arguing that it had been made with a clear purpose of affecting the outcome of the case.³⁰⁸

Canada and Mexico also made submissions to the Tribunal, which supported the arguments of the US on both jurisdictional issues and the merits of the case.³⁰⁹ For the first time in an investor-state dispute, third parties (several NGOs) were also permitted to submit briefs to the Tribunal. The procedural decision of the Tribunal to allow such briefs is discussed in Section 7.1.

Outcome

The Final Award of the Tribunal was issued on 3 August 2005. As the majority of Methanex's arguments had focused on discriminatory treatment, and the First

³⁰⁷ *Methanex* Statement of Defense, at para 2, emphasis added.

³⁰⁸ *Methanex* Final Award, at para. II.B.14. Other investors made the same claim in other disputes that were proceeding at the time.

³⁰⁹ *Methanex Corporation v. United States of America*, Article 1128 Submission of Canada on Jurisdiction, 30 April 2001; Article 1128 Submission of Mexico on Jurisdiction, 30 April 2001; Article 1128 Submission of Canada on the Re-Submitted Amended Claim, 30 January 2004; Article 1128 Submission of Mexico on the Re-Submitted Amended Claim, 30 January 2004, <http://www.state.gov>.

Partial Award had largely limited the case to an analysis of the motivation behind the Californian measures, the bulk of the Final Award also dealt with these issues.

In the Tribunal's view, there was significant evidence that the measures in question were motivated by legitimate concern for the environment and the health and welfare of the population of California: "This policy was motivated by the honest belief, held in good faith and on reasonable scientific grounds, that MTBE contaminated groundwater and was difficult and expensive to clean up."³¹⁰ In particular, they found that the UC Report reflected, "a serious, objective and scientific approach to a complex problem in California."³¹¹ The Tribunal also rejected Methanex's conspiracy theory about ADM and Governor Davis, pointing out that California Senate Bill 521, which mandated gubernatorial action regarding MTBE, was passed by the California legislature prior to the election and that once he was Governor, Davis had no discretion to deviate from the results and recommendations of the UC Report.³¹² Furthermore, the Tribunal noted that the evidence suggested that the Government of California, far from favouring ethanol, aimed to receive a waiver from the US EPA standards so that it could prohibit the use of *all* gasoline oxygenates.³¹³ The Tribunal, therefore, found no breach of Article 1102.

With regards to Article 1105, the Tribunal addressed the issue of whether a breach of Article 1102 (had a breach been found) would have constituted a further breach of Article 1105. The Tribunal decided that Methanex's argument was untenable, even in the absence of the NAFTA FTC Notes of Interpretation, because the plain meaning of the minimum standard does not support the contention that it precludes discrimination.³¹⁴ As this was the entire basis of Methanex's claim on Article 1105, the Tribunal found that it had failed to make its case for a breach of this provision.

Although the discussion of expropriation was not extensive in Methanex's pleadings, and its claim was largely based on the supposed discriminatory nature of the measures, the Tribunal made an important decision on the issue, suggesting

³¹⁰*Methanex* Final Award, at para. III.A.102.2.

³¹¹*Ibid.*, at para. III.A.101.

³¹²*Ibid.*, at para. III.B.54.

³¹³*Ibid.*, at para. III.B.55.

³¹⁴*Ibid.*, at para. IV.C.14.

that:

... as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, *inter alios*, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.³¹⁵

Contrary to Methanex's claims, the Tribunal concluded that the California ban did not amount to expropriation.

Having dealt with the merits of the claim, the Tribunal returned to the issue of jurisdiction, which it had delayed in order to assess the issue of intent. The Tribunal found, as it had in its discussion of national treatment, that Methanex had failed to prove its case in respect of malign intent on the part of the Government of California.³¹⁶ As such, they concluded that there was no legally significant connection between the Californian regulations and Methanex and its investments, and the US jurisdictional challenge was therefore upheld. Thus despite having determined that Methanex's claims had failed on the merits, the Tribunal subsequently found that it lacked the jurisdiction to consider these claims, and dismissed the case accordingly.³¹⁷

Finally, the Tribunal dealt with the issue of costs. It found no compelling reason not to follow standard UNCITRAL practice, based on Rule 40.1, that the losing party should pay all of the costs of the arbitration. The amount that Methanex was required to reimburse the US for in this respect amounted to nearly US\$1.1 million.³¹⁸ The Tribunal also held that Methanex should cover the nearly US\$3 million that the US had incurred in legal fees.³¹⁹

³¹⁵ *Ibid.*, at para. IV.D.7. The effect of the 'caveat' with regard to "specific commitments" is unclear. Specific commitments could refer to a contract or stability agreement, but as noted in Chapter 4 of this study, there is continued debate as to whether breach of contract amounts to breach of international obligations.

³¹⁶ *Ibid.*, at para. IV.E.18.

³¹⁷ *Ibid.*, at para. IV.E.22.

³¹⁸ *Ibid.*, at para. V.13.

³¹⁹ *Ibid.*

5.3 Pending Cases

5.3.1 Glamis Gold v. United States

This case concerns California regulations requiring the reclamation of land following open-pit mining operations. A Canadian investor filed for arbitration under Chapter 11 of the NAFTA, arguing that the regulations amounted to expropriation and denial of fair and equitable treatment. As of early 2008, the case had progressed through the hearing on the merits, but a final award had yet to be issued.

Background

In 1987, Glamis Gold Ltd. (Glamis)³²⁰ began acquiring mining claims on federal public lands in the Imperial Valley of California. Under the General Mining Law of 1872, US citizens are allowed to acquire claims for mining on federal land simply by putting up posts and registering the claim with the Department of the Interior. To hold a claim, an annual maintenance fee of US\$100 per claim is required, but the federal government receives no rents or royalties from mining operations conducted on these lands.³²¹ Glamis established subsidiaries in the US to act as ‘citizens’ to acquire the claims. The Imperial Project consisted of approximately 187 mining claims.³²²

Prior to the development of any mineral operations, Glamis was required to submit several EIAs to the Bureau of Land Management (within the US Department of the Interior), which is responsible for the administration of mining claims on federal lands. There were several contentious issues surrounding the project, including the fact that the area of the proposed mine was “adjacent to two formally designated wilderness areas, critical habitat for the federally-listed desert

³²⁰ Glamis Gold Ltd. identifies itself as a publicly held Canadian corporation, incorporated under the laws of British Columbia. Glamis Gold Inc. is a wholly-owned subsidiary of Glamis Gold Ltd., and is incorporated under the laws of the State of Nevada. Glamis Imperial is a wholly-owned subsidiary of Glamis Gold Inc., and also a Nevada corporation.

³²¹ *Glamis Gold Ltd. v. United States of America*, Statement of Defense (*Glamis* Statement of Defense), 8 April 2005, at 3, <http://www.state.gov>.

³²² *Glamis Gold Ltd. v. United States of America*, Notice of Arbitration, 9 December 9 2003, at 5, <http://www.state.gov>.

tortoise and an area designated as a place of critical environmental concern for Native American cultural values.”³²³

Following a six year review of the project, the Bureau of Land Management decided that the no-action alternative was preferred (i.e. it recommended that there be no development of the mine) and in 2001 the Secretary of the Interior Bruce Babbitt officially denied the proposed plan of operations for the Imperial Project.³²⁴ However in late 2002, following a change of administration, the new Secretary of the Interior Gale Norton rescinded the decision and the Bureau of Land Management initiated a process for the project plan to be reconsidered. In anticipation of the possible approval of the Imperial Project, the State of California began to take steps to mitigate the potential impacts of it and other open-pit mine developments. In particular, California Senate Bill 22 was passed in 2003, stipulating that Californian authorities may not approve the reclamation plan for surface mining operations located within one mile of any Native American sacred site or located in an area of special concern,³²⁵ unless it is stipulated that all excavations would be backfilled and graded to achieve the approximate contours of the land prior to mining. In addition to aiding in the restoration of the visual landscape, backfilling also reduces the potential environmental damage caused by cyanide leaching from waste rock piles.³²⁶

The Dispute

On 31 July 2003, Glamis submitted a Notice of Intent to Submit a Claim under Chapter 11 of the NAFTA.³²⁷ In the Notice of Intent, Glamis argued that two Chapter 11 rules had been violated by California and thereby the US: the prohibition of expropriation (Article 1110) and the requirement to provide fair and equitable treatment to foreign investors (Article 1105). The company’s Notice of

³²³Non-Party Submission of the Quechan Indian Nation, 19 August 2005, at 1, <http://www.state.gov>.

³²⁴*Glamis* Statement of Defense, at 11-2.

³²⁵As defined by the California Desert Conservation Area Plan of 1980.

³²⁶*Glamis* Statement of Defense, at 9.

³²⁷*Glamis Gold Ltd. v. United States of America*, Notice of Intent to Submit a Claim to Arbitration, 21 July 2003, <http://www.state.gov>.

Arbitration was filed in December 2003.³²⁸ As of early 2008, the dispute was proceeding under the UNCITRAL rules of arbitration.

Glamis argued that the measures taken by the US and California individually and collectively amounted to an expropriation. Glamis focused on Senate Bill 22 in particular, stating that “there was little doubt about the discriminatory and expropriatory purpose of this legislation,”³²⁹ and suggested that because the backfilling requirements are mandatory and non-discretionary, they resulted in the complete destruction of the economic value of the company’s investment.³³⁰ According to Glamis, the company “undertook the significant investment necessary to establish and begin gold mining operation,”³³¹ including “less than 2 million in acquiring and developing the mineral rights” prior to 1994 and “an additional 13 million ... in the acquisition, exploration and development of the Imperial Project” as of December 2002.³³² However, Glamis’ original claim was for a sum not less than US\$50 million, based on the fair market value of the property interests owned by Glamis Imperial.³³³ Glamis later amended its claim to not less than US\$49.1 million in compensation for the loss of the property, plus further damages that “the Tribunal may deem appropriate for the United State’s failure to accord Glamis the minimum standard of treatment.”³³⁴

In its Memorial, Glamis argued that in addition to covering direct expropriation and indirect expropriation, Article 1110 also creates an additional category of measures *tantamount* to expropriation.³³⁵ This is an issue that arose early on in Chapter 11 arbitrations: in *Metalclad* the US responded to an inquiry from the Tribunal about the meaning of the phrase ‘tantamount to expropriation,’ stating that it is the government’s position that the phrase explains what the meaning of indirect expropriation is but “does not assert or imply the existence of an additional

³²⁸ *Glamis Gold Ltd. v. United States of America*, Notice of Arbitration (*Glamis* Notice of Arbitration), 10 December 2003, <http://www.state.gov>.

³²⁹ *Ibid.*, at 10.

³³⁰ *Ibid.*

³³¹ *Ibid.*, at 6.

³³² *Ibid.*, at 7.

³³³ *Ibid.*, at 10-1.

³³⁴ *Glamis Gold Ltd. v. United States of America*, Memorial (*Glamis* Memorial), 5 May 2006, at 317, <http://www.state.gov>.

³³⁵ *Ibid.*, at 229.

type of action that may give rise to liability beyond those types encompassed in the customary international law categories of ‘direct’ and ‘indirect’ nationalization or expropriation.”³³⁶ The *S.D. Myers* Tribunal also rejected the argument that ‘tantamount to’ meant anything other than ‘equivalent to’.³³⁷ In its Statement of Defense, the US asserted that, “[t]he measures of which Glamis complains have not resulted in a taking of anything of value from Glamis,” further noting that the financial viability of the Imperial Project had long been in question.³³⁸ The US also argued that the company did not have ‘reasonable investment-backed expectations’ that its project would not be subject to strict requirements, as it would have been aware of the complex and stringent regulatory environment present in the State of California.³³⁹ Finally, the US argued that regulatory measures intended to protect the public health and the environment “are not, absent rare circumstances not present here, of the type that can be deemed expropriatory.”³⁴⁰

With respect to Article 1105, Glamis argued that the minimum standard obliged California to act in *good faith* and in a manner that was not *arbitrary*, and furthermore to provide a *transparent* and *predictable* framework for investment, with due regard to the *legitimate expectations* of an investor.³⁴¹ While the FTC Notes of Interpretation preceded the commencement of this case, Glamis argued that customary international law had evolved to incorporate these conditions, and that therefore its claims did not fall outside the scope of the Article.³⁴² In its Counter-Memorial, the US argued that Glamis’ criteria for the international minimum standard had not been shown to be general and consistent state practice as required for consideration as customary international law.³⁴³ Nevertheless, the US also defended the actions of both the federal and state governments against Glamis’ allegations of arbitrariness, and a lack of transparency and predictability.³⁴⁴

³³⁶ *Metalclad* US Article 1128 Submission, at para. 9.

³³⁷ *S.D. Myers* First Partial Award, at para. 285.

³³⁸ *Glamis* Statement of Defense, at 18.

³³⁹ *Ibid.*, at 19-20.

³⁴⁰ *Ibid.*, at 20.

³⁴¹ *Glamis* Memorial, at 288-310.

³⁴² *Ibid.*, at 288-301.

³⁴³ *Glamis Gold Ltd. v. United States of America*, Counter Memorial, 19 September 2006, at 226, <http://www.state.gov>.

³⁴⁴ *Ibid.*, at 235.

The US also raised the issue of Glamis' nationality and pointed out that in the proposed mining plan, the subsidiary described its ultimate owner, Glamis Gold Ltd. as a "publicly-owned US corporation."³⁴⁵ This issue was also a key point in the joint non-party submission of Friends of the Earth Canada (FOE-Canada) and Friends of the Earth US (FOE-US).³⁴⁶

On 31 May 2005, the Tribunal issued a procedural order notifying the parties that it would address both jurisdictional issues and the merits of the case in its final award, despite the request of the US for a preliminary award on jurisdiction.³⁴⁷

In two sessions in August and September 2007, a total of nine days of hearings on the merits of the case were held. The hearings were open to the public.³⁴⁸ During the hearings, the key points of contention between the parties were: (i) the property rights actually possessed by Glamis; (ii) the ripeness of the company's claim; (iii) the interpretation of the two standards at issue; and (iv) the application of these standards to the facts of the case.

With respect to the company's property rights, the US argued that these rights were circumscribed by certain 'background principles'. In other words, because pre-existing laws (e.g. the 1975 Sacred Sites Act, the 1975 Surface Mining and Reclamation Act) prohibited Glamis from undertaking activities that would irreparably damage sacred Native American sites, and also explicitly contemplated that the backfilling of pits might be required, Glamis had never possessed an unrestricted right to conduct its operations in whatever manner it preferred. Glamis countered that California laws could not be considered to represent background principles that could constrain a federal property interest. Furthermore, Glamis argued that because the Surface Mining and Reclamation Act did not mandate complete backfilling, it did not represent a pre-existing obligation. Finally, Glamis argued that the fact that mines with approved reclamation plans were grandfathered was sufficient evidence that the California measures did not merely

³⁴⁵ Qtd. in *Glamis* Statement of Defense, at 9, emphasis added by US.

³⁴⁶ *Amicus Curiae* Submissions of Friends of the Earth Canada and Friends of the Earth United States, 30 September 2005, <http://www.naftaclaims.com>.

³⁴⁷ *Glamis Gold Ltd. v. United States of America*, Procedural Order No. 2, 31 May 2005, <http://www.state.gov>.

³⁴⁸ The transcripts of the hearings can be found on the US State Department website, <http://www.state.gov>.

implement background principles.

In terms of the issue of ripeness, the US pointed to the fact that Glamis had never actually submitted a reclamation plan, and thus the California measures had never been implemented with respect to the company. The US argued that until a measure is actually applied to a claimant the issue is not ripe for arbitration because, for example, it is impossible for a tribunal to gauge the economic impact of the measure, and thus determine whether an expropriation has occurred. Glamis argued that it should not be required to take steps that are clearly futile (i.e. to submit a reclamation plan that does not comply with Senate Bill 22 and have it rejected) in order for its claim to be ripe.

With regard to the interpretation of measures tantamount to expropriation, both parties argued that the key issue was the economic impact of the measures. The US argued that this issue was paramount because without evidence of a full or nearly full deprivation of an investment an expropriation claim must fail. On the other hand, Glamis argued that economic impact was the critical issue because if a total deprivation was shown to have occurred then no further analysis was required by the Tribunal. While the US argued that because the denial of the project proposal by the Department of Interior had been rescinded, Glamis could resume the approval process and eventually (theoretically) commence mine development, Glamis asserted that the California measures had made their project economically infeasible. The parties presented valuation reports to back up their claims about the economic impact of the California measures. The US presented a valuation study based on Glamis's own contemporaneous documents which indicated that the mining claims retained a significant value (US\$9.1 million) after the California measures were adopted. The US further argued that by the time of the hearings in 2007, the value of the property had increased substantially to US\$159 million as a result of the phenomenal rise in gold prices in the interim period. Glamis argued to the contrary that its property had a value of US\$49.1 million prior to the enactment of the reclamation requirements, but retained no value thereafter. The company suggested that the US figures were preposterous and neglected important factors such as rising mine operation costs. Glamis also put forth that if the mining claims had retained any value, the company would have received purchase offers.

While both sides argued that the expropriation analysis should end with eco-

nomic impact – the US because it had proved that there was none, and Glamis because it had shown that a full deprivation had occurred – they both also offered further steps of analysis in the event that the Tribunal disagreed with their interpretation of the standard or with their valuation findings. Both parties suggested that two further analytical steps were well established in US and international takings jurisprudence: determination of the investor's reasonable investment-backed expectations and determination of the character of the measure(s).

Echoing the decision in *Methanex*, the US suggested that investors who operate in highly regulated industries, in highly regulated jurisdictions such as California, cannot have reasonable expectations that they will not be subject to extensions of those regulations, unless the government has made 'specific commitments' to the investor in that respect. The US pointed out that Glamis had no approved project plan or contract, which might qualify as specific commitments. On the other hand, Glamis argued that while specific commitments are a factor in the determination of reasonable expectations, their absence is not determinative. Glamis suggested that the Tribunal should look at the other types of assurances that the company had received, including statements of officials charged with implementing the legal regime. Glamis suggested that the California measures amounted to an 'undue regulatory surprise', while the US countered that they were incremental and evolutionary in nature.

With regard to the assessment of the character of the measures, the US argued that numerous international arbitral tribunals have concluded that, except under rare circumstances, nondiscriminatory regulations enacted for a public purpose will not be deemed expropriatory and compensable. While the US suggested that arbitral tribunals generally accept a government's characterization of a measure as 'regulatory', Glamis argued that the motivation of the government must be interrogated. In this respect, Glamis put forth that the California measures were not only discriminatory (because they did not apply to nonmetallic mines) but also were specifically targeted at the company. Glamis further argued that even regulation that is intended to protect the public must not disproportionately burden individuals. In rebuttal, the US argued that the situation of metallic and nonmetallic mines were distinct enough to justify their separate treatment, and that furthermore, the fact that an environmental regulation fails to address every environmental problem does not make the regulation discriminatory. In addition, the US argued that while

Glamis' project might have been the impetus for the development of the California measures, those measures were not specifically targeted at the company and had in fact been applied to another mining project. Finally, the government argued that it was perfectly reasonable for a company to have to shoulder the burden of dealing with environmental damage that it had itself caused through its operations.

With respect to the second article of NAFTA that was invoked in the case, Article 1105, the parties once again had some basis of agreement. The parties concurred that Article 1105 refers to a customary international law standard and does not create an independent treaty standard. Nevertheless, the parties disagreed on the content of the standard. Glamis relied heavily on arbitral decisions that had interpreted 'fair and equitable treatment' as requiring governments to act transparently, to act in a manner that does not frustrate an investor's reasonable expectations, and to refrain from arbitrary conduct. The US first disputed that the requirements set forth by Glamis could be shown to be general and consistent state practice as required for them to amount to customary international law, and second objected to the notion that these requirements had, in any case, been breached. The US pointed to the partial annulment of the *Metalclad* Award in a Canadian court based on the Tribunal's incorporation of a standard of transparency not found in NAFTA Chapter 11. However, even if the Tribunal agreed with Glamis' interpretation, according to the US there was no basis for a claim that the government of California had not acted transparently, pointing out that public hearings were held prior to the adoption of the measures. The US also argued that frustration of an investor's expectations could not form the basis of a stand-alone claim of a breach of customary international law. Furthermore, the US reiterated its argument from the expropriation analysis that Glamis could not have reasonable expectations that it would not be subject to backfilling requirements. Glamis responded by repeating its claim that it had been specifically targeted by the government of California and that the true purpose of the measures had been to terminate the company's project.

As of the close of 2007, the final award in this case was pending. The State of California has expressed serious concerns about what a victory for Glamis in this case could mean for their ability to regulate. In a letter to the US Trade Representative, the California Senate Select Committee on International Trade Policy and State Legislation wrote that the case "provides a striking demonstration

of the threats posed to the traditional regulatory power of state governments as a result of current models of trade and investment agreements.”³⁴⁹

5.4 Analysis

The cases in this chapter illustrate that there is a wide range of environmental issues implicated in investment arbitration, and further that several different types of regulation (denial of permits, bans on trade, remediation requirements) have been claimed to be in breach of the regulative rules and norms of investment protection. It would appear, from the limited number of cases reviewed, that breach of the national treatment standard, breach of the minimum standard/fair and equitable treatment, and expropriation are the most common claims made by investors in environmentally relevant cases, and also are the claims that are most likely to be successful. While the interpretation of these standards remains a fluid process, several trends are discernible that are worthy of particular note.

5.4.1 Different Circumstances or Different Interpretations?

In the accounts of academics and other observers, the cases detailed above are usually briefly summarized with the author very clearly taking a position on the outcome. For example, as Weiler notes:

The ‘story’ of *Metalclad v. Mexico* has become quite well known in different circles; it just so happens that it has been told in dramatically different ways, depending upon the circle. In circles inhabited by the opponents of trade and investment liberalisation, as well as those who more generally profess an amorphous ‘anti-globalisation’ ethos, *Metalclad* is a story about the rights of foreign corporations trumping the popular will of the citizens of a small, Mexican municipality. For trade and investment lawyers, and associated policy analysts, it is just a familiar story - about international investment being held hostage to regulatory decision-making in a developing country.³⁵⁰

³⁴⁹Letter from California Senate Select Committee on International Trade Policy and State Legislation to Robert B. Zoellick, 17 November 2003, <http://www.tradeobservatory.org>.

³⁵⁰Weiler 2005, at 701.

Despite acknowledging the disparate accounts of the case, Weiler himself professes that there is no middle ground to be taken, and that the trade and investment lawyer position is the correct one.

It is argued here that the circumstances of each case and the interpretation of the standards in each case must be differentiated. Is it that observers view the facts of each case differently or do they take issue with the application of investment law to these facts by arbitral tribunals? Weiler, in the above quotation, is referring to the circumstances of the *Metalclad* case. However, even if one agrees with his argument that the investor was treated poorly by Mexico, one can still debate the specific interpretations of the regulative rules and norms of investment protection proffered by the *Metalclad* Tribunal.

One can compare the *Metalclad* case with the remarkably similar (in terms of circumstances) *Tecmed* case. While the tribunal in each case found that the Mexican government had expropriated an investment, the *Metalclad* Tribunal applied the effects test, and most controversially noted that it need not consider the motivation for the adoption of the measure establishing the ecological reserve. As Mann and Araya point out, “[b]y arguing that the purpose is simply not relevant, the tribunal established a precedent that could be interpreted as broadly limiting a state’s authority to engage in environmental protection.”³⁵¹ In contrast, although the *Tecmed* Tribunal also concluded that an expropriation had occurred, it applied a more balanced approach of considering the effect, purpose, and proportionality of a measure. Similarly, the Tribunal in *S.D. Myers* considered the purpose of the government measure. However, the focus given to the temporary nature of the ban on PCB exports leaves open the question of how the *S.D. Myers* Tribunal would have assessed the measure had it not eventually been repealed. In contrast, the *Methanex* Tribunal dealt with a permanent measure, but nevertheless found that it did not amount to an expropriation.

Even in a limited examination of only four cases one can find several distinct interpretations of one standard. These discrepancies are not solely the result of the different circumstances in each case, but also a consequence of the broad scope left to tribunals to interpret standards. It can be concluded, therefore, that standards such as expropriation are not only determined on a *case-by-case basis* (according

³⁵¹ Mann and Araya 2002, at 171.

Table 5.1: Summary of First-Order Cases I

Case	Year Commenced - Year Concluded	Environmental Issue	Government Measure	Level of Government	IIA	Arbitral Rules
<i>Ethyl v. Canada</i>	1996-1998	Air pollution	Ban on MMT (gasoline additive)	Federal	NAFTA	UNCITRAL
<i>Santa Elena v. Costa Rica</i>	1995-2000	Biodiversity	Expropriation of property to expand a park	Federal	None	ICSID
<i>Metalclad v. Mexico</i>	1996-2000	Hazardous waste	Revocation of landfill operation permit	Municipal	NAFTA	ICSID AF
<i>S.D. Myers v. Canada</i>	1998-2002	Hazardous waste	Ban on transboundary movement of PCBs	Federal	NAFTA	UNCITRAL
<i>Tecmed v. Mexico</i>	2000-2003	Hazardous waste	Revocation of landfill operation permit	Municipal	Spain-Mexico BIT	ICSID AF
<i>Methanex v. United States</i>	1999-2005	Water pollution	Ban on MTBE (gasoline additive)	State (California)	NAFTA	UNCITRAL
<i>Luccetti v. Peru</i>	2002-2007	Biodiversity	Closure of a pasta factory	Municipal	Chile-Peru BIT	ICSID
<i>Glamis Gold v. United States</i>	2003-	Biodiversity, water pollution	Backfilling requirements for open-pit mines	State (California)	NAFTA	UNCITRAL

to varying circumstances) but also on a *tribunal-by-tribunal basis* (according to varying interpretations).

The same can be said for fair and equitable treatment. Both the *Tecmed* and *Metalclad* tribunals read this standard very broadly to incorporate requirements for the government to act *transparently* and *consistently*. Behrens questions whether “any government in the world” would be able to live up to the transparency requirement as it was defined in *Tecmed*.³⁵² The Supreme Court of British Columbia found that the *Metalclad* Tribunal erred in incorporating transparency into the evaluation of fair and equitable treatment; however, this decision remains a topic of heated debate amongst academics and other interested observers.³⁵³

The discussion of the minimum standard/fair and equitable treatment in the *S.D. Myers* and *Methanex* cases focused more on the issue of discrimination. The *S.D. Myers* Tribunal found that breach of the national treatment standard amounted to breach of the minimum standard as well. In contrast, the *Methanex* Tribunal disagreed with this interpretation. While in the NAFTA context this issue appears to have been definitively decided for future cases (through the FTC Notes of Interpretation), it is questionable whether tribunals outside of the NAFTA will agree with the *S.D. Myers* interpretation or the *Methanex*/FTC interpretation.

To sum up, although the circumstances of each case differ substantially, this alone does not account for the divergence in tribunal decisions. This is not to claim that the circumstances of a case are immaterial, but only to argue that the viewpoints and perspective of arbitrators are also relevant. This makes the outcome of cases more difficult for states to predict.

5.4.2 Evolution of Standards or Double Standards?

Many supporters of investment protection suggest that interpretations of the regulative norms and rules are undergoing a natural process of evolution and refinement as more cases are examined and as arbitrators build on the decisions of previous tribunals. In particular, they point to the *Methanex* Award as proof that the broad effects test adopted to determine expropriation in the *Metalclad* case has

³⁵² Behrens 2007, at 175.

³⁵³ Weiler 2003, at 47, argues that “the local judge was wrong in substituting his uninformed opinion for that of the tribunal.” See also Brower 2002; 2001a; Thomas 2002.

Table 5.2: Summary of First-Order Cases II

Case	Claims					Jurisdiction	Outcome	Tribunal Findings					Annulment or Court Review
	NT	MFN	MST/ F&E	EXP	PR			NT	MFN	MST/ F&E	EXP	PR	
<i>Ethyl v. Canada</i>	X			X	X	Yes	Settlement						No
<i>Santa Elena v. Costa Rica</i>				X		Not disputed	Compensation				X		No
<i>Metalclad v. Mexico</i>	X	X	X	X	X	Joined to merits; Yes	Compensation			X	X		Award annulled in part
<i>S.D. Myers v. Canada</i>	X		X	X	X	Joined to merits; Yes	Compensation	X		X			Award upheld
<i>Tecmed v. Mexico</i>	X	X	X	X		Joined to merits; Yes	Compensation			X	X		No
<i>Methanex v. United States</i>	X		X	X		Joined to merits; No	Dismissed						No
<i>Luccetti v. Peru</i>	X	X	X	X		No	Dismissed						Jurisdictional Award upheld
<i>Glamis Gold v. United States</i>			X	X		Joined to merits	Pending						

been supplanted by a more reasonable interpretation, which Gaines argues sets “a high bar for investor claimants to vault over to gain compensation from host states” reducing the chances for a successful claim “and thus the incentive for investors to mount challenges to national regulatory actions.”³⁵⁴

However, other observers caution against premature jubilation, noting in particular that in the absence of a system of precedent, an arbitrator could just as easily follow the reasoning of the *Metalclad* Tribunal as that of the *Methanex* Tribunal.³⁵⁵ Given the broad support that the *Metalclad* Award has received amongst many investment law experts, the possibility of future awards in the same line is not inconceivable. Furthermore, it does not appear that the *Methanex* decision has dissuaded investors from pursuing cases related to environmental regulation or from relying on pre-*Methanex* decisions.³⁵⁶

It has also been questioned whether greater deference was given to the Californian measures in *Methanex*, not because the understanding of the expropriation standard had naturally evolved over time, but because this case was against a large and powerful country. Sornarajah argues that, “[o]ne has to wait until the rich states are affected before there can be change,” and questions whether the change will be uniform, or whether a *double standard* will emerge.³⁵⁷ Similarly, Van Harten cautions that:

... arbitrators may choose to limit state liability only where a damages award could provoke controversy among decision-makers and the public in the major states. If so, this would be the right result for the wrong reason. By encouraging adjudicators to tread softly on powerful governments while maintaining strict disciplinary standards for those less powerful, such reasoning jeopardizes the neutrality of treaty arbitration.³⁵⁸

Finally, while one could argue that the expropriation standard has been subjected to stricter, narrower, interpretations over time, it would seem that the opposite is true for the the minimum standard/fair and equitable treatment. Thus, the

³⁵⁴Gaines 2006, at 689.

³⁵⁵Lawrence 2006, at 293; Mann 2005, at 9.

³⁵⁶See cases cited in note 3.

³⁵⁷Sornarajah 2006b, at 33, emphasis added.

³⁵⁸Van Harten 2007a, at 147

question arises as to whether investors will continue to challenge environmental regulation, but simply shift their focus to the latter standard.³⁵⁹

5.4.3 Limits to Investment Protection?

IAs are developed in such a manner as to limit the protections that they offer to a specific group of investors and investments under a specific set of circumstances. However, several cases suggest that these limitations may be less effective than states had anticipated.

For example, the *Ethyl* Tribunal accepted jurisdiction over Ethyl's claims despite its acknowledgment that the company had 'jumped the gun' in filing for arbitration before the MMT Act was in force. One NGO report referred to Ethyl's actions as a "blatant attempt to intimidate a legislative body from taking action."³⁶⁰ In effect, the Tribunal's decision sanctions Ethyl's behaviour, and thereby encourages other company's to act in the same manner. An NGO report suggests that "[t]hreats to use Chapter 11 are now a routine lobbying instrument."³⁶¹ The use of the threat of arbitration to influence policy outcomes will be discussed much more extensively in Chapter 6.

Another example is the *Glamis Gold* case, which raises questions about the limitations on investor nationality. Ochs points out that it is ironic that in this case the company is claiming mining rights available only to US citizens at the same time as it invokes NAFTA-based rights available only to non-US companies.³⁶² If corporations are permitted to either shift nationalities at will or create multiple nationalities, it not only undermines the reciprocity aspect of IAs, it also creates further uncertainty for governments about which investors are covered by treaty rights.³⁶³

In contrast, two other cases suggest that some limitations are being placed on the scope of investment protection. While in the *Lucchetti* case the decision on jurisdiction was largely based on technicalities, the fact that the Tribunal ac-

³⁵⁹Sornarajah 2006a, at 345.

³⁶⁰Public Citizen 2001, at vii.

³⁶¹Mann 2001, at 16.

³⁶²Ochs 2005, at 511.

³⁶³Wallace 2005, at 366.

knowledge that corruption could be considered as a basis for why the dispute had not been definitively terminated prior to the entry into force of the BIT is somewhat encouraging. It suggests that tribunals are potentially willing to examine evidence on egregious conduct by foreign investors. The decision of the *Methanex* Tribunal that a legally significant connection between a measure and an investment is required is also significant, as it rules out the possibility of investors only incidentally affected by regulation being granted protection.

5.5 Implications for Environmental Governance

This section moves from the general review of environmentally relevant investor-state disputes, to an exploration of their potential implications for environmental governance, particularly in developing countries.

5.5.1 Legitimate Regulation and Legitimate Expectations

Legitimacy is currently a popular word in the political science literature, and it is also frequently used by states, investors, and arbitrators in the context of investor-state disputes. In particular, it is employed with relation to the measures adopted by governments, and in regard to the expectations of investors (as mentioned in Sections 4.1.2 and 4.1.3). The cases in this chapter illustrate that tribunals feel justified in interrogating the legitimacy of government regulation and that they will assess the legitimacy of investor expectations to varying degrees. It appears in some cases that the actions of governments are scrutinized far more closely than those of investors.

Supporters of investment protection argue that legitimate regulation will not be found in breach of regulative rules and norms of investment protection and further that arbitral tribunals are equipped to make decisions on the legitimacy of government actions. Gantz notes that, “[i]n theory at least, one of the strengths of the NAFTA legal system is to permit arbitral tribunals to distinguish between legitimate government regulatory activity and arbitrary, discriminatory or expropriatory actions, and to discourage (and require compensation) the latter.”³⁶⁴ Sim-

³⁶⁴Gantz 2001, at 655-6.

ilarly, Brower argues that there is no support for the proposition that Chapter 11 undermines “legitimate regulatory programs,” and Wälde suggests that investment arbitration “is about the dissection of national regulation to identify elements that can stand up to the sober examination of international law to distinguish what is legitimate regulation and what is excessive interference with proprietary and contractual rights.”³⁶⁵

The question of the legitimacy of government policy in the environmental context primarily relates to the concern that regulation will be utilized as a cover for protectionism. There is evidence in each case discussed above that the governments involved had genuine concerns about the environment. However, there were also indications that other issues played a role, as is likely to be the case in practically all political decisions. For example, it has been suggested that the Canadian ban on PCB exports related to intense lobbying that the government had received on the part of S.D. Myers’ Canadian competitors.³⁶⁶ In *Methanex*, all of the investor’s claims were built on the intent of California to favour domestic ethanol producers over foreign methanol producers. The question is whether the existence of multiple factors influencing a government, which is arguably inevitable given the complexity of the issues raised in these disputes, provides proof that environmental concern is not legitimate. Loy makes the crucial point that, “[v]irtually every piece of environmental or conservation legislation or regulation affects a commercial sector, and will thus be politically supported (or opposed) by private interest groups.”³⁶⁷ He calls this the ‘Baptist/Bootlegger’ problem, and questions “[h]ow much should this possible duality matter?”³⁶⁸ Kurtz makes a further relevant argument:

The ‘smoking gun’ nature of protectionist statements should not be dispositive in themselves. Politicians will often engage in such populism for a variety of factors not least of which is the ever present desire for re-election. A test based on identification of protectionist intent cannot workably be based on the subjective intent of a single legislator.³⁶⁹

³⁶⁵Brower 2001a, at 69; Wälde 2001, at 30.

³⁶⁶Weiler 2001, at 177.

³⁶⁷Loy 2002, at 24.

³⁶⁸*Ibid.*

³⁶⁹Kurtz 2007, at 342.

Orellana also argues that under international law, state responsibility is tied only to the representations of officials at the highest levels of government and that attaching liability to statements made by lower level officials “risks introducing havoc into the administrative workings of Governments.”³⁷⁰

A second issue related to the legitimacy of environmental regulation relates to the role of science. In *S.D. Myers*, the Tribunal appeared unconvinced that there was scientific evidence to support the fact that the transport of PCBs across the Canada-US border was potentially dangerous to the environment, and this skepticism factored into the decision that the Interim Order was motivated by protectionism rather than legitimate environmental concern. However, one could interpret the available scientific information differently, for example, by giving greater weight to the numerous decisions of the US EPA that it was preferable for PCB waste to be disposed of in Canada. The existence of an extensive scientific report from a respectable academic institution was given considerable weight by the *Methanex* Tribunal in their determination that the California phase-out of MTBE was legitimate. The question which inevitably arises is how much scientific evidence is required to convince a tribunal? Furthermore, will a government’s capacity to gather sound scientific information factor into a tribunal decision on the legitimacy of a regulation? For example, if scientific evidence is contested, but the investor has access to more convincing scientific or technical studies, will this sway an arbitral tribunal against a developing country that adopted a regulation based on only the scientific information which it could gather with limited human and economic resources?³⁷¹

It is argued here that the *precautionary principle* has not been incorporated into the reasoning of arbitral tribunals.³⁷² Jones notes the dilemma that governments face in the absence of a clear adoption of the precautionary principle in the institution of investment protection:

A government could forbid the use of the product as soon as it learns of its potential danger, but it would then face litigation by negatively affected foreign investors. Alternatively, the government could wait to amass more

³⁷⁰ Orellana 2007, at 740.

³⁷¹ Alvarez-Jiménez 2006, at 430. See also Orellana 2007, at 745.

³⁷² For a different perspective see Newcombe 2007a.

scientific evidence while hoping that the product is not later found to be dangerous. If the product were found to be harmful, the government would likely be criticized for not acting sooner to curtail use of the product and could then face litigation from its own injured citizens. Under either scenario the government risks substantial liability.³⁷³

The precautionary principle is especially important for developing countries, for whom a high-standard requirement of scientific evidence is more difficult to achieve.

Turning to the legitimacy of investor expectations, it would appear that tribunals are much more forgiving. The most critical example of this is *S.D. Myers*, where the Tribunal awarded compensation to a company that had invested in an activity that, at the time, was completely illegal. The company was well aware of Canada's established policy of disposing of PCBs domestically and took on the significant risk that the US EPA would not provide it with an enforcement discretion. In such circumstances, how could the investor have had legitimate expectations that it could ship PCB wastes across the border? Similarly, *Metalclad* knowingly invested in a controversial landfill that had previously been denied permits. In *Methanex*, the existence of a highly-regulated environment coupled with a lack of 'specific commitments' made to the investor that regulations would not change, led the tribunal to conclude that the company did not have legitimate expectations. However, one has to question whether the existence of a highly regulated environment is an appropriate standard against which to measure investor expectations. Does the presence of lax standards conversely legitimize an investor's expectations that regulation will not change? Given the low-base level of regulation in developing countries, and the pressures from both domestic and international sources for governments to 'catch up' to international best practices, would it not be fair to assume that investors should expect regulation to change even more dramatically in developing countries than in developed ones?

5.5.2 Positive Obligations

An important trend visible in the *Metalclad* and *Tecmed* cases in particular, and also evident in the literature as discussed in Chapter 4, is the growing acceptance

³⁷³Jones 2002, at 556.

of *positive obligations* of investment protection. Thus, protecting investment no longer solely requires a state to *refrain* from taking certain actions, it also mandates compliance with ‘good governance’ principles. As Reisman and Sloane argue, governments must “establish and maintain an appropriate legal, administrative, and regulatory framework, the legal environment that modern investment theory has come to recognize as a *conditio sine qua non* of the success of private enterprise.”³⁷⁴ Not only is regulation subject to challenge, so too is the *failure* to regulate.³⁷⁵ This is consistent with the neo-Gramscian argument that, under the new constitutionalism, states are required to do both less and more.

The trend is certainly not universally accepted or welcomed. The expansion of the scope of the minimum standard was met with considerable disquiet in all three NAFTA states, and resulted in the issuance of the Notes of Interpretation. Outside of the NAFTA context, it may be more difficult for governments to adopt an interpretation of the standard, and furthermore, it is not even clear whether this type of measure conclusively resolves the issue. The promulgation of the Notes, when several Chapter 11 disputes were ongoing, caused consternation amongst many observers who argued that not only was the timing inappropriate, but furthermore that the Interpretation of the minimum standard in fact amounted to an amendment of the NAFTA.³⁷⁶ Cook has gone so far as to claim that the interpretation is a “severe curtailment of rights provided for under the ‘fair and equitable treatment’ clause” and “is contrary to the plain meaning of the language” and thus constitutes “a violation of the Vienna Convention on the Law of Treaties, which has risen to the level of customary international law and requires treaties to be interpreted in accordance with their plain meaning.”³⁷⁷ Despite the uproar, others suggest that the Interpretation, far from amounting to an amendment, may not preclude the inclusion of elements such as transparency in an analysis of the minimum standard at all. As Kirkman has noted, equating fair and equitable treatment with the minimum standard may only serve to intensify the debate on the current

³⁷⁴Reisman and Sloane 2003, at 117.

³⁷⁵*Ibid.*, at 129.

³⁷⁶See the discussion in *Pope & Talbot v. Government of Canada*, Interim Award on Damages, 31 May 2002, <http://www.international.gc.ca>. See also the submissions in *Methanex* of the investor, the US, Canada, and Mexico re: NAFTA FTC Statement on Article 1105, <http://www.naftaclaims.com>.

³⁷⁷Cook 2007, 1112-3.

status of customary international law in the area; investors and many arbitrators may argue that the standard has evolved (and expanded) considerably in recent history.³⁷⁸ As noted above, this has been the strategy adopted by Glamis Gold.

What are the implications of an expanded notion of the minimum standard and fair and equitable treatment requiring positive obligations on the part of states? It certainly provides greater scope for investors to launch disputes, and therefore counteracts any narrowing of the scope of regulatory takings may have occurred. It also arguably disproportionately affects developing countries. Many poor states are still struggling to establish the very fundamental elements of a functional democratic system. The imposition of ‘good governance’ requirements (transparency, accountability, etc.) in the form of aid conditionality has been fraught with difficulty and controversy.³⁷⁹ It is fair to assume that this new form of *investment conditionality* will be equally contentious.

5.5.3 Multilevel Governance

Another critical aspect to recognize in the cases described in this chapter is that in almost all instances they revolved around either measures taken by local or regional governments (*Luccetti, Metalclad, Tecmed, Methanex, Glamis Gold*) or measures taken by a national government in pursuit of international objectives (*Santa Elena, S.D. Myers*). Thus, the cases reflect the now well-established phenomena of ‘multilevel governance’ in the environmental field. They also raise cause for concern in this respect.

In investment arbitration, only the national level of government can be held liable for compensation, regardless of the level of government responsible for the offending action. As such, national governments have an incentive to prevent sub-national governments from adopting laws that are prone to challenge.³⁸⁰ Dhooge notes that the mandate of national governments is clear: they “must establish the limits of subnational jurisdiction existing through the exercise of the police powers and stringently enforce those limits by taking prompt and effective action against

³⁷⁸ Westcott 2007, at 430; Kirkman 2002, at 471.

³⁷⁹ See Doornbos 2001.

³⁸⁰ Kelemen 2004, at 273.

non-complying state and local governments.”³⁸¹

Multilevel governance may particularly complicate matters when it comes to the payment of monetary damages to a successful claimant. The Mexican government reportedly missed a payment deadline to Metalclad because of ongoing disputes with the various levels of government involved in the case about the appropriate division of the cost of the settlement.³⁸² In Canada, the Federation of Canadian Municipalities has requested that the national government “guarantee that it will never penalize municipalities for actions that are valid under domestic law but violate NAFTA.”³⁸³ Been and Beauvais suggest that if the US government faced payment of an award based on local or state regulations it could adopt several different strategies: it could sue the state or local government for the cost of compensation; it could deduct the amount of the award from grants or other funds it would otherwise make available to the state or locality; it could condition future funding for the state or locality upon its agreement to rescind or modify the regulation in an effort to avoid future liability; or it could preempt, or conditionally preempt, the state or locality’s regulation.³⁸⁴ Clearly any of these strategies could result in a reallocation of power and authority over environmental regulation between various levels of government.³⁸⁵

Concern about liability under investment agreements could lead to efforts to (re)centralize control over aspects of environmental governance, in opposition of the trend of decentralization in recent years, especially in developing countries.³⁸⁶ While Kelemen rightly argues that centralization of power also results from the harmonization of social regulation, the consequences of sub-national governments deviating from such commitments are less immediate than in the case of violations of trade and investment agreements.³⁸⁷

With regard to the other end of multilevel environmental governance - inter-

³⁸¹Dhooge 2001, at 264-5.

³⁸²Been and Beauvais 2003, at 90.

³⁸³Qtd. in *ibid.*

³⁸⁴Been and Beauvais 2003, at 135-6.

³⁸⁵Been 2002, at 58; see also Luz and Miller 2002, at 976, who argue that Chapter 11 will lead to an erosion of provincial power and authority in Canada.

³⁸⁶See Larson and Ribot 2005.

³⁸⁷Kelemen 2004, at 273.

national law developed under multilateral environmental agreements - the *Santa Elena* and *S.D. Myers* cases are particularly relevant. In *S.D. Myers*, the Tribunal suggested that it should not be presumed that a breach of a regulative rule of investment protection could be justified by the existence of an international environmental commitment, because the state is obliged to adopt measures that are least inconsistent with investment protection. While the argument that a state presented with a “variety of equally effective and reasonable means”³⁸⁸ to protect the environment should choose the one that is most consistent with investment protection does not appear unreasonable on its face, the notion that an arbitral tribunal is better equipped than a democratically-elected government to decide what regulations are effective and reasonable is certainly contestable. In *Santa Elena*, the Tribunal reasoned that the existence of international obligations to protect the environment did not affect the level of compensation owed to an investor. Wagner argues that requiring governments to pay compensation to implement measures developed in line with multilateral environmental agreements “interferes with efforts to address global environmental problems through international consensus.”³⁸⁹

5.5.4 Paying the Polluters?

Several NGO reports have suggested that the *S.D. Myers*, *Ethyl*, and *Metalclad* cases have turned the polluter pays principle into ‘pay the polluter’ principle.³⁹⁰ Similarly, Madalena suggests that “[i]nvestment treaties do not follow the well-settled polluter pays principle, but impose a sacrifice on the community at large, in the detriment of sustainable development under the auspices of a broadly interpreted right to property.”³⁹¹ On the other hand, according to Kentin, the cases decided to date display “a rather restrained attitude in awarding high amounts of damages with a few exceptions.”³⁹² Investors are generally awarded much less than they claim. Metalclad, for example, criticized the amount of damages that it received, calling it “a token amount of money” that failed to reflect the actual value

³⁸⁸*S.D. Myers* Partial Award, at para. 221.

³⁸⁹Wagner 1999, at 535.

³⁹⁰Mann 2001, at 33; Public Citizen/FOE 2001 at 9.

³⁹¹Madalena 2003, at 82. See also Hasic 2005, at 155-6.

³⁹²Kentin 2004, at 336.

of the investment.³⁹³ Nevertheless, it should be noted that it is quite possible that investors have significantly inflated their compensation claims in these cases, including speculations about future profits. Table 5.3 compares the damages sought by investors with the actual damages awarded in each case.

It is suggested here that what is more crucial is that there does not appear to be any acknowledgment of the principle of *common but differentiated responsibilities* in the institution of investment protection. In fact, the purpose of investment protection arguably is to make the obligations of states uniform, despite varying levels of development. Neither Costa Rica nor Mexico's ability to pay was mentioned in the tribunal decisions in *Santa Elena*, *Metalclad*, and *Tecmed*. Brower and Wong argue that the tribunal in *Santa Elena* did *implicitly* address this issue and:

... granted compensation in an amount that, on the one hand, would not 'break' Costa Rica, or worse still, tempt it for lack of funds to consider returning a World Heritage Site back to its owners for development into a 'Disney-fied' golf-courses-and-hotels resort, and, on the other hand, would not so far disappoint [the investor's] expectations as to cause it to seek annulment of the Award.³⁹⁴

However, without explicit recognition of this principle, developing country governments may be wary of the financial consequences of defending an environmental regulation in arbitration.

5.6 Summary

This chapter has examined the complexities of actual cases of investor-state disputes related to the protection of the environment that have been resolved in investment arbitration. The cases reviewed related to several different environmental issues, and a range of regulatory actions in both developed countries (Canada and the US) and developing countries (Peru, Costa Rica, and Mexico). The aim of the chapter was not to pass judgment on the decisions of tribunals but rather to

³⁹³Dhooge 2001, at 259.

³⁹⁴Brower and Wong 2005, at 774.

Table 5.3: Compensation Sought vs. Compensation Awarded (in millions)

	<i>Damages Sought</i>	<i>Damages Awarded</i>
<i>Ethyl v. Canada</i>	US \$251	US \$13
<i>Luccetti v. Peru</i>	US \$156	0
<i>Santa Elena v. Costa</i>	US \$41	US \$16
<i>Metalclad v. Mexico</i>	US \$90	US \$16.7
<i>Tecmed v. Mexico</i>	US \$52	US \$5.5
<i>S.D. Myers v. Canada</i>	US \$20	CDN \$6.9
<i>Methanex v. United</i>	US \$970	US -\$4.5
<i>Glamis Gold v.</i>	US \$50	?

examine the interpretations of the regulative rules and norms of investment protection that have been employed in arbitral practice and to identify whether any discernible trends have emerged despite the absence of formal precedent in investment arbitration. Additionally, an effort was made to examine the extent to which tribunals have sought to balance public and private interests. It has been argued that the jurisprudence is inconsistent, and that it does not resolve the uncertainty surrounding the interpretation of the norms and rules of investment protection. Given the small number of cases, it is difficult to determine whether standards are being refined or whether instead each arbitrator is likely to follow the particular decisions that he agrees with.

Despite the inconsistency in tribunal decisions, several implications for environmental governance have been identified. It has been argued that Tribunals are not likely to accept a state's purported reasons for adopting an environmental measure on its face, but will instead assess the measure's legitimacy. In this respect, science plays an important role, but the precautionary principle appears to be absent from the reasoning of tribunals. Tribunals appear less interested in examining the behaviour of investors, which suggests that they do exhibit a degree of pro-investor bias. The emergence of a more expansive interpretation of the minimum

standard/fair and equitable treatment standard to cover issues such as transparency and consistency in government behaviour toward investors is also notable. This issue was identified in Chapter 4, but the cases in this chapter have highlighted the implications of this approach when it is applied in practice. The implications of investment protection for multilevel governance were also discussed in this chapter. While investment arbitration is only accessible to national governments, a great deal of responsibility for the regulation of the environment, in both developed and developing countries, is delegated to state, provincial, or municipal levels of government. This dichotomy could lead to conflict between levels of government and efforts to re-centralize power. Investment protection may also affect the implementation of multilateral environmental agreements, requiring governments to take measures that are least inconsistent with investment protection, perhaps at the expense of the efficiency and effectiveness of environmental regulation. Finally, it was argued that while the awards in the cases discussed in this chapter have not been as high as the claims (or as high as the awards in several non-environmental cases) it is evident that tribunals do not (at least explicitly) accept the principle of common but differentiated responsibilities.

6

Second-Order Outcomes

While most research on the relationship between investment law and environmental policy focuses on disputes that are resolved in international arbitration, many conflicts between investors and states will likely never reach this stage. Arbitration is a high-risk, high-cost option for both governments and investors. Furthermore, states are concerned with the effect that formal disputes may have on their reputation as investor-friendly hosts. This chapter provides a detailed examination of investor-state conflicts that were resolved without recourse to arbitration, but where the existence of investment protection nevertheless played an important role in the outcome. Conflicts concerning both environmental policy (in Ghana, Indonesia, and Costa Rica) and domestic court proceedings (in Indonesia and Ecuador) are examined.

6.1 Conflicts Over Policy

This chapter deals with two categories of investor-state conflicts; those that concern *policy* and those that concern *domestic court proceedings*. This section examines several investor-state conflicts that have arisen over environmental policies.

6.1.1 Open-Pit Mining in Indonesia's Protected Forests

This case concerns a law banning open-pit mining in Indonesia's protected forests.¹ Several mining companies holding contracts in areas of protected forest threatened to take the government to arbitration if the ban was applied to their prospective mining operations. The conflict garnered significant attention from the public and was drawn out over several years. Eventually, the government exempted a number of companies from the ban.

Background

In 1999, following the fall of the New Order Regime, the Government of Indonesia passed a number of reform laws, including Law no. 41 Year 1999 Stipulation to the Act on Forestry. Article 1 provides several basic definitions, including the designation of various types of forest.² These include: 'production' forests, which are allocated mainly for the exploitation of forest products; 'protection' forests, which have the chief function of maintaining life-supporting hydrological systems, preventing floods, controlling erosion etc.; and 'conservation' forests, which are principally aimed at preserving plant and animal diversity. Article 38 stipulates that that open-cast mining is prohibited in protection forests. The reason for this prohibition is that to expose and mine the ore in an open-cast design, it is generally necessary to excavate a large area and to relocate a large quantity of 'waste rock'. Two of the main environmental concerns of the construction of open-pit mines are the disruption of the ecosystem where the mine is excavated, and the disposal of the waste rock. Other environmental impacts also ensue from the building of roads to service mines, which requires the clearance of land, results in changes to the hydrological functioning of the ecosystem, and opens access to the area for exploitation from other sectors. In Indonesia, increasing the accessibility of protection forests to illegal loggers is a major concern.

Mineral investment in Indonesia is organized under contracts-of-work (CoWs). In the early years of the CoW system (1967-1970), the majority of the content in

¹ An earlier version of this case study was published in Tienhaara 2006b.

² An unofficial translation of the law was found on the *Public Participation Forum (FPPM) website*, <http://www.fppm.org>.

the contracts was negotiated, but later a standardized text on terms pertaining to technical, legal and general matters was adopted.³ However, periodic changes to laws and regulations on taxation and financial matters required adjustment to the standardized terms, resulting in several ‘generations’ of contracts.⁴ A CoW specifies land rents, royalties and other payments to be made by the investor to the government. In addition, it describes the environmental obligations of the company, although these are for the most part general statements which, as Hamilton remarks, “lack the specificity required to allow effective inspection and enforcement of their terms.”⁵ With regard to the settlement of disputes, there are options for arbitration under internationally accepted rules. In later generations, the contracts specifically make reference to UNCITRAL Rules.

In addition to access to investment arbitration, the CoW also has two critical elements for attracting investors: conjunctive title and *lex specialis*. Conjunctive title refers to the fact that if a commercial discovery is made, the CoW allows for the contractor to proceed from the initial stages of surveying and exploration all the way through to exploitation and marketing. *Lex specialis* in this instance refers to the fact that the terms and conditions of CoWs, which are passed into law, are not subject to changes in the general laws and regulations of Indonesia. As Barberis explains, “the CoW, once approved by Parliament, has the status of law. Therefore in the case of conflict between the law and regulations of Indonesia and the CoW, the CoW supersedes.”⁶

The Conflict

Prior to the entry into force of Forestry Law 1999/41, a number of CoWs had been signed covering areas of protection forests. In fact, over 150 companies were supposedly affected by the ban on open-cast mining. At first, the companies carried on with their activities as they presumed that the legislation would not be applied retroactively and that, in any case, the contracts were *lex specialis* and

³Hoed 1997, at 122.

⁴Between 1967 and 1998, 236 CoWs were signed, the majority in the 4th generation (1985-1990) and 6th generation (1997).

⁵Hamilton 2005, at 38.

⁶Barberis 1998, at 47.

would therefore not be affected. The issue was eventually brought to the attention of the public and was taken up by a number of NGOs. The Forestry department stopped issuing permits to mining companies in protection forests and all affected contracts were effectively suspended.

In 2002, reports began to emerge that several foreign mining companies were threatening to bring the Government of Indonesia to international arbitration on the matter of the Forestry Law. Several NGOs declared that the threat of arbitration was without basis.⁷ The following reasons were cited:

- All contracts state that companies must conform with the relevant environmental protection laws and regulations of Indonesia;
- The law only prohibits surface mining, whereas underground mining is still permitted;
- All the contracts in protected areas were signed during the period of authoritative government, and the Forestry Law was made under democratic rule;
- The preservation of protected areas is an issue of global concern with popular support; and
- Indonesia is bound by international commitments including the provisions of the CBD,⁸ and the Statement of Forest Principles and also participates in the United Nations Forum on Forests.

The issues raised by the NGOs are worth some further examination.

The first point, that companies must comply with the relevant environmental laws of Indonesia, is accurate. For example, the CoW of Pt. Nusa Halmahera Minerals (Australia) states that the company shall:

In accordance with the prevailing Environmental protection and natural preservation laws and regulations of Indonesia from time to time in effect, use its

⁷“Mining Industry Threatens Indonesia with International Arbitration,” *Friends of the Earth Indonesia (WALHI) and Mining Advocacy Network (JATAM) News Release*, 4 April 2002, <http://www.jatam.org>.

⁸Togu Manrung, a professor at the Bogor Institute of Agriculture and director of Forest Watch Indonesia, has suggested that allowing mining in protected forests would specifically violate Articles 7 and 8 of the CBD. See “Open Pit Mines Endanger Lives, Nature,” *The Jakarta Post*, 21 September 2002.

best efforts to conduct its operations under this Agreement so as to minimize and cope with harm to the Environment and utilize recognized modern Mining industry practices to protect natural resources against unnecessary damage, to minimize Pollution and harmful emissions into the Environment, to dispose of Waste in a manner consistent with good Waste disposal practices, and in general to provide for the health and safety of its employees and the local community.⁹

The use of the terminology “time to time in effect” suggests that investors should not expect regulations to remain frozen over the course of the contract. Gross argues that the clear requirement of companies to comply with environmental regulations, combined with the absence of stabilization clauses in the CoWs, rules out the possibility that the companies could effectively argue that there was a breach of contract by Indonesia.¹⁰ Additionally, according to a report in *The Jakarta Post*, a noted lawyer told legislators that they should not worry about being sued for breach of contract because the Forestry Law had been ratified by the House of Representatives (DPR) and any agreements signed between the government and investors could not violate Indonesian law.¹¹ However, the investors argued that this conclusion failed to take into account the fact that CoWs also have the status of law in Indonesia, and are thus effectively stabilized.

Whether the companies could have claimed breach of treaty standards, for example under the UK-Indonesia BIT, the Australia-Indonesia BIT, or the 1987 Association of South-East Asian Nations (ASEAN) Agreement for the Promotion and Protection of Investments, is another question. Gross has analyzed the various options and has concluded that: “the Government of Indonesia could have likely beaten the mining companies’ claims at a preliminary/jurisdictional phase, and certainly on the merits.”¹² If the companies were to argue that the Forestry law was a breach of treaty, then the second point in the NGO statement (that only one

⁹Contract of Work between the Government of the Republic of Indonesia and Pt. Nusa Halmahera Minerals, 17 March 1997, Jakarta, at Art. 26. It should be noted that CoWs are not, in general, public documents, although model CoWs have been published. A copy of this specific CoW was obtained from an NGO in Jakarta. Several other CoWs were also retrieved by the author from company filings to the Securities and Exchange Commission (SEC), <http://pro-edgar-online.com>.

¹⁰Gross 2003, at 896.

¹¹“House Urged to Challenge Mining Ruling,” *The Jakarta Post*, 2 July 2004.

¹²Gross 2003, at 901.

method of mining - surface mining - is banned) would likely be a key point for debate on whether the ban qualified as a taking. The mining companies rejected the notion that alternatives to open-cast mining exist, arguing that underground mining operations are not feasible because more than 90% of Indonesia's mineral potential is found in the top soil layer (around 0-50 metres).¹³ Thus, in the view of investors, a ban on open-cast mining is effectively a complete prohibition on all mining activities and thus a clear case of an expropriation. If the case had gone to arbitration, the companies would also likely have argued that the ban did not fall under Indonesia's police powers. As the forests in question are classified as protection rather than conservation forests, the mining companies argued that the issue of biodiversity conservation is not relevant.¹⁴ However, Dr. Hariadi Kartodiharjo, a lecturer at the Bogor Agricultural Institute, suggests that regardless of how the areas have been classified, mining in protection forests will result in permanent devastation of the environment, a raised threat of extinction of rare species, and a decrease in water supply to the Barito River and millions of people living along the riverbank.¹⁵

The third point in the NGO statement (that the contracts were signed under a period of authoritarian rule) is rather beyond the scope of this study, but it is an issue that has been considered by others. Sornarajah notes that:

It is an interesting point as to whether international lawyers who promote the norm of democracy would concede that concessions and other foreign investment agreements signed by dictators or unrepresentative governments should be considered invalid. It is possible to argue that the norm of self-determination, now having acquired a near *ius cogens* status would invalidate concession agreements signed by unrepresentative rulers.¹⁶

In this instance it seems unlikely that any arbitration panel would consider this issue, as government officials have consistently stated that contracts signed under

¹³“Minister of Forestry Ready to Implement DPR Decision on Mining,” *MiningIndo*, 1 September 2003.

¹⁴“IMA Responds to NGOs and Mining in Forestry Critics,” *MiningIndo*, 30 July 2003.

¹⁵“Government Warned of Catastrophe from Mining in Protected Forests,” *MiningIndo*, 8 March 2004.

¹⁶Sornarajah 2004a, at 42.

the New Order regime would be honoured.¹⁷

Finally, it is questionable whether the last two points in the NGO statement, relating to forest preservation as an issue of global concern and the obligations of the government under MEAs, would have any influence on an arbitral tribunal, given the conclusions drawn from the cases analyzed in the previous chapter.

Outcome

In any event, discussion of how a tribunal would deal with this case will remain hypothetical. In 2002, the Government of Indonesia produced a list of 22 companies with CoWs signed prior to the promulgation of Forestry Law 1999/41 that they recommended be given approval to operate in protection forests. How this list was devised from the original 150 or so affected companies is not clear. Furthermore, the list did not remain constant over time; half of the companies were removed (due to gloomy business prospects) and a further 11 were added, leading State Minister for the Environment Nabeli Makarim to ask “whether twenty-two was a sacred number.”¹⁸ In November of 2003, it was reported that 13 ‘prioritized’ companies from the list of 22 would be allowed to continue operations with the issuance of a Presidential Decree, but the actual issuance of the Decree was put off until a later date.¹⁹ These companies were apparently prioritized because their operations were seen to be economically viable. The 9 companies on the original list of 22 that were not included on the prioritized list of 13 were reported to have made continued threats to sue the government. In March 2004, Paul Louis Coutrier, an executive of the Indonesian Mining Association, was quoted as stating that the 9 companies had strong grounds to file a lawsuit, though he hoped that the conflict would be settled out of court.²⁰ The threat was particularly strong from PT Inco (Canada), but this company was later confirmed to, in fact, be on the prioritized list of 13.

On 11 March 2004, Perpu (government regulation substituting a law) no.

¹⁷Freeport McMoran Copper & Gold Inc. Form S-3 (Securities Registration Statement, simplified form). Filed 4 November 2001. Washington D.C.: SEC, <http://pro-edgar-online.com>.

¹⁸“Government Questioned Over Mining In Protected Forest,” *The Jakarta Post*, 19 July 2003.

¹⁹“13 Mining Sites get Forest Status Changed,” *MiningIndo*, 6 November 2003.

²⁰“Mining Firms Threaten to Sue Indonesian Government,” *Bisnis Indonesia*, 12 March 2004.

1/2004 was issued by the Government of Indonesia to add a new provision to the 1999 Forestry Law stating that, “[a]ll permits or contracts in mining in forest areas which were issued before the promulgation of Law 41 of 1999 on Forestry are declared to remain valid until the expiration date of the respective permit or contract.”²¹ It also stated that further implementation of the Perpu would be determined by Presidential Decree.²² The Indonesian Constitution of 1945 provides that a Perpu should be utilized only in “a pressing matter of utmost urgency.” This type of measure had only been used once before by the Megawati administration, following the 2002 Bali terrorist bombings.²³ Many environmental groups questioned the “utmost urgency” of the mining issue, but also pointed out that the Perpu did not actually change the position of the companies, whose contracts had never been declared invalid.

The Presidential Decree (41/2004) issued in May was more specific and named the 13 companies that would be allowed to continue operations in protection forests. The Decree also stated that the operations would be further regulated under a separate decree to be issued by the Ministry of Forestry. Immediately following the issuance of the Presidential Decree, a group of NGOs issued a statement that they would bring the Perpu, which had not yet been approved by Parliament, before the Constitutional Court for Judicial Review. Following the development of a special commission and much deliberation, the DPR finally voted on the Perpu in July. Initially it appeared that the emergency law would be rejected,²⁴ and the NGOs were confident that they “had the numbers” needed to defeat it.²⁵ However, the Perpu was passed into law (Law no. 19/2004) by a vote of 131 to 102²⁶ amidst allegations of corruption. NGOs reported that they had been informed that

²¹“Indonesian Forestry Issue Resolved,” *Weda Bay Minerals News Release*, 17 March 2004, <http://www.allbusiness.com>.

²²“Mining in Protected Forests – Government Gives Way to Mining Industry Pressure,” *Down to Earth* No. 61, May 2004.

²³“Nickel Miner to Sue Indonesian Government,” *Asia Times*, 17 March 2004.

²⁴Irwan Prayitno, Speaker of the Commission VIII of the DPR, was reported to state that if the Perpu was passed to the DPR it would be rejected. See “DPR to Decline Approval of Mining in Protected Forest,” *MiningIndo*, 20 April 2004.

²⁵Author’s confidential interviews with nongovernmental representatives (#1 and #7), Jakarta, July 2005.

²⁶“Disputed Mining Bill Endorsed,” *The Jakarta Post*, 16 July 2004.

the government would provide Rp1 billion for every faction in the national parliament that voted to allow the mining operations to go ahead.²⁷ These allegations were corroborated by several members of Parliament who came forward claiming to have been offered bribes.²⁸ The money for the bribes was allegedly solicited from the mining companies by the Department of Mines.²⁹

In late September 2004, the Ministry of Forestry issued its Ministerial Decree (no. 12/2004), outlining restrictions on the operations of companies permitted in protection forests. According to a spokesperson for the Ministry: "The Decree is designed to limit the potential destruction caused by mining operations on natural forests and the environment."³⁰ Included in the Decree was a requirement for companies to pay a bond to cover the costs of rehabilitating areas following mine closures, and also to provide alternate areas of land for reforestation.

In 2005, in what appeared to be the last hurdle for the government, the Constitutional Court conducted its review of Perpu no.1/2004 and Law 19/2004. The Minister of Forests was reported to have stated that he would be happy if the Court annulled the law,³¹ but it did not. Instead the judges concluded that:

Although this Court shares the opinion of all the experts brought by the appellants regarding the dangerousness and negative impacts of open pit mining in protected forests, nevertheless this Court also understands the reasoning for the need for transitional regulation which continues the legal status or rights gained by mining companies before the advent of the Forestry Law.³²

The Constitutional Court president reportedly also stated that "We can understand the government's argument that the regulation should be issued otherwise it would

²⁷"NGOs Allege Bribery in Indonesian Government Bid to Allow Mining Permits to Resume in Protected Forest," *MiningIndo*, 13 November 2002; "Lawmakers Smell Fishy Deal behind Mining Regulation," *The Jakarta Post*, 24 July 2004.

²⁸*Ibid.*

²⁹The author's confidential interview with a foreign embassy official (#4), Jakarta, July 2005.

³⁰"Forestry Ministry Softens Stance on Mining," *MiningIndo*, 1 October 2004.

³¹"Constitution Court to Conduct Judicial Review over Mining in Protected Forest," *MiningIndo*, 17 February 2005.

³²Conclusions of the Judgement of the Constitutional Court, qtd. in "Constitutional Court Rules no to BHP et al. in Indon Protected Forests," *NGO Forum for Protected Forests News Release*, 8 July 2005, <http://www.eng.walhi.or.id>.

face difficulties in developing a *favorable investment climate*.”³³

While the Minister of Environment has stated that no more licenses (beyond the 13) should be issued, there is certainly potential for further threats of arbitration. In fact, by singling out 13 companies, the government has actually made the case of other companies far stronger as they could now also claim discriminatory treatment.³⁴ Furthermore, the additional requirements imposed on companies operating in protection forests included in the Ministerial Decree issued in late 2004 (later issued as Regulation No. 14/2006) may also be subject to challenge. The Chair of the Indonesian Mining Association, Jeffrey Mulyono, was reported to be particularly upset with the requirement that mining firms operating in protection forests would have to provide a “compensatory site” twice as large as the mining concession. According to Mulyono, the requirements will cause unnecessary problems for mining firms and could deter future investment in the sector.³⁵ An Inco report to the US Securities and Exchange Commission (SEC) also alludes to this issue:

While PT Inco continues to believe that the terms of its Contract of Work provide it with all authorizations needed to conduct mining activities in the areas covered by its Contract of Work and any disputes relating to its Contract of Work are *subject to arbitration* under international conventions, if the Forestry Regulation restricts PT Inco’s ability to mine in certain areas, it could reduce PT Inco’s estimated ore reserves and adversely affect PT Inco’s long-term mining plans.³⁶

Epilogue: Indonesia’s Draft Mining Bill

Indonesia has been in a protracted debate over the development of a new mining bill for several years. The bill, intended to supersede Law No. 11/1967 on mining,

³³“Mining in Protected Forests Legalized,” *The Jakarta Post*, 8 July 2005, emphasis added.

³⁴Author’s confidential interviews with a nongovernmental representative (#7), and a mining investor (#9), Jakarta, July 2005.

³⁵“Mining Group Objects to New Forest Guidelines,” *The Jakarta Post*, 31 May 2006.

³⁶Inco Limited. 2005. Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended June 30, 2005. Commission file number 1-1143. Washington D.C.: SEC, emphasis added.

originally aimed to replace the CoW system with exploration and production licenses, to be awarded by local administrations in line with the regional autonomy law.³⁷ However, foreign investors have made it abundantly clear that they do not favour this move. International accounting and consulting firm PricewaterhouseCoopers called on the government to keep the CoW system, noting that the proposed change to the system “hasn’t been well received by foreign investors,” and would deter investment in the sector.³⁸ The managing director of mining giant Rio Tinto has also stated that, “[i]t would be of interest to Indonesia to keep its [CoW] for long-life, large-scale projects,”³⁹ and a group of major mining companies issued a ‘white paper’ in March 2007, calling on the government to do so.⁴⁰ The Indonesian Mining Association has also urged the government to keep the CoW system, as it provides greater legal certainty than the proposed licensing system.⁴¹

Many investors have argued that local administrations, after obtaining greater autonomy in 2001, have been too aggressive in attempting to collect revenue by creating new taxes and levies, which in turn has created a burden on businesses.⁴² They have also argued that the involvement of local governments reduces predictability in the investment process.⁴³ It is also clear, that the ability to access international arbitration is a key concern for investors.⁴⁴ One observer has noted that:

If one were to strip away the rhetoric and get right down to the issue that really has industry concerned about the mining law being debated in the House of Representatives (DPR), it would be the proposed shift from independent international arbitration to a local government decision as a dispute settlement mechanism.⁴⁵

³⁷“Lawmakers Debate New Mining Bill to Install New System,” *The Jakarta Post*, 6 February 2006.

³⁸“Lingering Legal Concerns Deter Mining Investors,” *The Jakarta Post*, 23 January 2006; “Don’t Scrap CoW for Mining Licenses,” *Jakarta Post*, 01 March 2007.

³⁹“Mining Law Must Provide Certainty and Equality,” *The Jakarta Post*, 20 February 2007.

⁴⁰“Miners Issue ‘White Paper’ Against Draft Mining Law,” *The Jakarta Post*, 21 March 2007.

⁴¹“Don’t Scrap CoW for Mining Licenses,” *Jakarta Post*, 01 March 2007.

⁴²“Govt Plans New Measures to Improve Investment Climate,” *The Jakarta Post*, 17 February 2006.

⁴³“We Want Predictability, Say Mining Firms,” *The Jakarta Post*, 31 January 2007; “Controversial Mining Bill Likely to be Passed,” *The Jakarta Post*, 23 February 2007.

⁴⁴“Don’t Scrap CoW for Mining Licenses,” *Jakarta Post*, 01 March 2007.

⁴⁵“Dispute Resolution and the Environment,” *Jakarta Post*, 25 April 2007.

In June 2007, the House Commission working on the draft decided that a CoW-type system would be incorporated into the new bill for large mining projects involving a total investment of more than US\$250 million.⁴⁶ Thus, while the bill had not been passed at the time of writing, the indication is that the pressure from the mining companies has strongly influenced the draft. The draft bill has also been criticized by NGOs and government parties for paying little attention to the environment.⁴⁷

6.1.2 Mining in Ghana's Forest Reserves

This case concerns a conflict over a moratorium on mining activities in forest reserves in Ghana.⁴⁸ The moratorium was put in place in 1996, but at that point several mining companies had already carried out exploration activities in the reserves and wished to proceed with mine development. The conflict pitted the Forestry Commission against the Minerals Commission, and garnered significant attention from NGOs. There were also indications that the government was threatened with arbitration from the affected investors. The government eventually allowed five companies to carry out mine operations within the forests, subject to specific environmental guidelines.

Background

Ghana has a very long history of mining, particularly of gold, dating back to pre-Christian times; in the colonial period it was known as the 'Gold Coast'. Mining law in Ghana was reformed under a World Bank structural adjustment programme in the 1980s. The 1986 Minerals and Mining Law provided for referral of disputes to arbitration in accordance with the UNCITRAL Rules, or within the framework of a BIT. Ghana has concluded 21 BITs; some of the agreements had been ratified while others were still awaiting ratification.⁴⁹

⁴⁶"House Wants New Agency for Mining," *The Jakarta Post* 19 June 2007.

⁴⁷"A Green PKB Wants Mining Bill Revised," *The Jakarta Post*, 28 February 2007.

⁴⁸An earlier version of this case study was published in Tienhaara 2006a.

⁴⁹"Treaties of Ghana," *ICSID website*, <http://icsid.worldbank.org>, accessed 4 January 2008. The US has also signed three agreements with Ghana - the OPIC Investment Incentive Agreement, the Trade

The 1986 Minerals and Mining Law recognizes three stages of mineral development, and an investor requires a separate license for each stage: reconnaissance, prospecting, and mining. In terms of mineral tenure, there is no automatic right for the holder of a reconnaissance licence to acquire a prospecting licence, but there is an automatic right for the holder of a prospecting licence to obtain a mining lease.⁵⁰ Mining leases are valid for up to 30 years, and generally include renewal clauses.⁵¹ Negotiations for licences and leases are normally led by the Minerals Commission, and the country's Constitution requires any contract or undertaking to be ratified in Parliament by a two-thirds voting majority. However, ratification has little impact on the substantive content of agreements.⁵² According to Ayine *et al.*, "[w]hether and when contracts become available to the wider public depends on whether the Parliamentary Committee invites public comments on the contract document; for most agreements placed before Parliament this does not happen."⁵³

In the course of this research, three mining leases⁵⁴ were obtained from company filings to the SEC in Washington D.C.⁵⁵ These examples give some insight into the substantive content of Ghanaian mining leases, although it should be cautioned that other leases may differ significantly. Furthermore, it should be noted that in addition to mining leases, a more recent trend has been for companies to sign more general 'investment agreements' with the government. For example, in 2003, Newmont Mining Corp. signed an investment agreement that covered its investments under three mining leases.⁵⁶ This trend is in line with Ghana's new

and Investment Framework Agreement, and the Open Skies Agreement - but these are not traditional BITs.

⁵⁰ Addy 1999, at 237; Omalu and Wälde 1998.

⁵¹ Addy 1999, at 237.

⁵² Ayine *et al.*, at 2005.

⁵³ *Ibid.*, at 3-4.

⁵⁴ Mining Lease signed between the Government of the Republic of Ghana and Canadian Bogosu Resources Ltd., 21 August 1987. Mining Lease signed between the Government of the Republic of Ghana and Canadian Bogosu Resources Ltd., 16 August 1988. Mining Lease signed between the Government of the Republic of Ghana and Bogoso Gold Ltd., 29 June 2001.

⁵⁵ All three leases are now under the control of Golden Star Resources Ltd. The 1987 and 1988 leases can be found in Golden Star Resources Ltd., SEC Form 10-K (Annual Report) Filed 29 March 2006, for Period Ending 31 December 2005, and the 2001 lease can be found in Golden Star Resources Ltd., SEC Form 8-K Filed for Period Beginning 25 October 2001, <http://pro-edgar-online.com>.

⁵⁶ "Newmont Joins Mining List," *Ghana News Agency*, 19 December 2003.

mining law, which will be discussed further below.

Returning to the content of the leases, it can be noted that with regard to environmental provisions, they are quite general:

The company shall adopt all necessary and practical precautionary measures to prevent undue pollution of rivers and other potable water and to ensure that such pollution does not cause harm or destruction to human or animal life or fresh water or vegetation.⁵⁷

In terms of dispute settlement, the 1987 and 1988 leases refer to the jurisdiction of ICSID for settlement by reconciliation or arbitration, while the more recent 2001 lease refers to UNCITRAL Rules. All three leases also have a second section to the arbitration clause, which provides for some stability. For example, the 2001 Mining Lease with Bogoso Gold Ltd. states that:

The Parties acknowledge and agree that this Agreement was made on the basis of the laws and conditions prevailing at the date of the effective conclusion of the negotiation of this Agreement and accordingly, if thereafter, new laws and conditions come into existence which unfairly affect the interest of either party to this agreement, then the party so unfairly affected shall be entitled to request a re-negotiation and the parties shall thereupon re-negotiate. The parties hereby undertake and covenant with each other to make every effort to agree, co-operate, and negotiate and to take such action as may be necessary to remove the causes of unfairness or disputes.⁵⁸

The Conflict

Mining activities in Ghana are concentrated in the south of the country, as this is where the most substantial mineral deposits are found. Incidentally, this is also the area within which the majority of Ghana's remaining forestland is located.

Permanent forest estate, in the form of reserves, was developed by the colonial government in the early part of the last century, in recognition of the increasing pressures on Ghana's forests. The intention was to maintain climatic quality, protect watersheds and ensure an environment conducive to cocoa production.⁵⁹ The

⁵⁷ Art. 8b of all three leases.

⁵⁸ Art. 35(d)

⁵⁹ Kotey *et al.* 1998, at 23.

demarcation of the forest estate was largely completed by 1939. While it is widely acknowledged that much of the forest estate has been degraded despite the reserve status, it has also been suggested that without the reserves “Ghana wouldn’t have any forest left.”⁶⁰ Ghana has an estimated 5.5 million hectares of forest, which the Food and Agriculture Organization (FAO) of the United Nations reports it is losing at a rate of 2% per year.⁶¹ According to one report, ten to twelve thousand people depend on forest reserves directly for their food and livelihood.⁶² The reserves are also significant stores of biodiversity, containing over 700 types of tropical trees and many endangered species including: 34 species of plant, 13 species of mammal, 23 species of butterfly, and 8 species of bird.⁶³

Following the promulgation of the 1986 Minerals and Mining Law, several gold mining companies were granted permission by the National Defense Council (NDC) government to carry out exploration activities within forest reserves. As early as 1992, the Forestry Commission was raising concerns about the potential impacts that mining could have on the reserves:

Mining in forest reserves will imply abandonment of scientific management of forest reserves and consequently loss of goods and services derived from our forest heritage set aside 60-70 years ago. Ghana could be sanctioned by the International Conservation organizations, which have credited Ghana with a long history of responsibility for tropical forest conservation and management.⁶⁴

In 1996, based on the apprehension about the depletion of the permanent forest estate and the potential for mineral activities to accelerate this depletion, the Ministry of Lands and Forestry placed a moratorium on mineral operations in forest reserves.⁶⁵

At the time of the moratorium, some mining companies had already reached advanced stages of exploration in forest reserves. The government selected sev-

⁶⁰ Author’s confidential interview with a non-governmental representative (#3), Accra, June 2005.

⁶¹ FAO 2007, at Annex Table 2.

⁶² “Mining Takes Heavier Toll on Ghana’s Biodiversity,” *Ghanaian Chronicle*, 27 September 2006.

⁶³ *Ibid.*

⁶⁴ Tuffuor 1992.

⁶⁵ Newmont Ghana Gold Ltd. 2005. Environmental and Social Impact Assessment: Ahafo South Project. Accra, <http://www.newmont.com>.

enteen companies, apparently on the basis of the level of investment incurred and the state of exploration that had been achieved, and determined that they should be allowed to continue with their exploration activities.⁶⁶ In 1997, the Operational Guidelines for Mineral Exploration in Forest Reserves for Selected Companies were produced and put in place to regulate exploration activities and the selected companies were invited to re-apply for Forest Entry Permits.⁶⁷

Up until this point, the issue had not been widely publicized. However, in 1998, Friends of the Earth (FOE)-Ghana began to investigate further. The group visited the exploration sites and spoke with companies, who claimed that if they found economically viable deposits they would be given mineral leases.⁶⁸ FOE-Ghana expressed alarm over the potential consequences for forest conservation and founded a Coalition of Civil Society Groups Against Mining in Ghana's Forest Reserves (FOE-Ghana Coalition).

In response to the concerns that were increasingly being raised over the possibility of mining in forest reserves, and in preparation for the expected transition from exploration to mine development, the Ghana Chamber of Mines, an association of representatives of mining companies operating in Ghana, took a fact-finding mission to South Africa and Australia, bringing with them representatives of the Forestry Commission, Environmental Protection Agency and other institutions. The purpose of the trip was to view successful mining operations in forests in these countries. Upon return from the trip the Chamber commissioned the preparation of the *Environmental Guidelines for Mining in Productive Forest Reserves*.

Outcome

By the time that the *Environmental Guidelines* had been published in 2001, a new government under the New Patriotic Party (NPP) had been elected, and had

⁶⁶Chirano Gold Project Scoping Report & Terms of Reference, Prepared by SGS Environment, Project No. B246. Available in the Ghana EPA Library, Accra.

⁶⁷Environmental Guidelines for Mining in Productive Forest Reserves in Ghana, May 2001, at 1.

⁶⁸Author's confidential interview with a non-governmental representative (#3), Accra, June 2005.

thus “inherited the problem” of the mining in reserves debate.⁶⁹ Under increasing public pressure, the list of proposed operations was decreased to five⁷⁰ and the government undertook visits to the proposed mine sites. The final approval for these operations came on 12 February 2003, in a letter issued by the Ministry of Mines to the Ghana Chamber of Mines.

The Ministry of Mines (now Ministry of Lands, Forestry and Mines) defended its decision to allow mining in forest reserves with several key arguments:⁷¹

- The companies had invested substantial sums of money and, if they were not allowed to proceed with mine development, the government would have to pay them compensation;
- Not allowing the companies to proceed would discourage future investments in the industry;
- The benefits of mining in terms of jobs and local infrastructure and royalties to the government outweigh the environmental consequences of mine development;
- The forest reserves earmarked for mining are not pristine, rather they have already been degraded; and
- Stricter environmental controls will be placed on companies operating in forest reserves (the Environmental Guidelines) and they will be required to plant trees outside of their concessions in addition to rehabilitating the mine area.

With regard to the first argument, according to several sources in Ghana, the threat of international investment arbitration was clearly made by companies with interests in the forest reserves, although there is disagreement from the sources

⁶⁹Mr. Kwadjo Adjei Darko, former Minister of Mines, qtd. in “Golden Greed: Trouble Looms over Ghanas Forest Reserves,” *World Rainforest Movement News Release*, n.d., <http://www.wrm.org.uy>.

⁷⁰The companies were Newmont (US), Nevsun Resources (acquired by AngloGold Ashanti/South Africa), Birim Goldfields (acquired by Goldenstar Resources/Canada), Chirano Goldmines (acquired by Redback Mining/Canada), and Satellite Goldfields (acquired by Goldenstar Resources/Canada).

⁷¹This summary of arguments is based on Tetteh 2004, various news articles quoted elsewhere in this section, and the author’s confidential interviews with mining investors (#1 & #20), government officials (#2 & #12), non-governmental representatives (#3, #4, #8 & #11), a representative of an international organization (#6), and academics (#9, & #18), Accra, Kumasi and New Abirim, June 2005.

over whether the government took the threat seriously,⁷² or merely used it as a convenient excuse to defend its position.⁷³ The main companies involved in the conflict were based in Canada, the US, and South Africa. Canada does not have a BIT with Ghana, there is no record of a South African BIT ever having been ratified, and the American agreements (a framework Agreement Concerning the Development of Trade and Investment Relations and an Investment Incentive Agreement) do not provide for investor-state dispute settlement. Therefore, it is unlikely that any of the companies could have brought a claim based on treaty rights. Furthermore, the companies did not have mineral leases, which would have provided some level of stability. However, security of mineral tenure in Ghana, as mentioned above, ensures that holders of a prospecting licence have a right to acquire a mineral lease for minerals that they discover in the area covered by the licence, and the national legislation provides access to arbitration.

As for the second argument made by the Ministry of Mines, about the value of the mining industry for the country, this is also disputed. Ghana is the second largest producer of gold in Africa (after South Africa), and gold has replaced cocoa as the leading foreign exchange earner.⁷⁴ However, a calculation by UNCTAD based on 2003 government figures showed that in that year Ghana earned only about 5% of the total value of mineral exports - about US\$46.7 million out of a total value of US\$893.6 million.⁷⁵ Furthermore, according to Awudi, the increased activity in the sector has not led to a significant increase in employment.⁷⁶

The Ministry's third claim, that the forest reserves to be mined were degraded, is also contested. According to one publication "Ghana mine operators roll their eyes at the 'reserve' designations because locals have already plundered them."⁷⁷ Even the former Minister of Mines Cecilia Bannerman has reportedly stated that "many of these reserves are reserves only on paper,"⁷⁸ and the Minister of Lands,

⁷² Author's confidential interviews with a government official (#7), an academic (#9), and a non-governmental representative (#11), Accra, June 2005.

⁷³ Author's confidential interviews with a non-governmental representative (#8), and academics (#9 & #18), Accra and Kumasi, June 2005.

⁷⁴ Awudi 2002, at 1.

⁷⁵ UNCTAD 2005a, at 50.

⁷⁶ Awudi 2002, at 1.

⁷⁷ "Country Winds up for Enviro-Mining Clash," *Mineweb*, 4 September 2003.

⁷⁸ *Ibid.*

Forestry and Mines at the height of the conflict, Prof. Dominic Fobih, had also referred to the forests in question as “so-called reserves.”⁷⁹ However, others have taken a different view, disputing the notion that the reserves in question were degraded and suggesting to the contrary that there were still areas of virgin forest.⁸⁰ It has also been suggested that it is illogical to conclude that because an area is degraded it should be “offered up for further degradation.”⁸¹ Even a representative of one of the mining companies involved in the debate admitted that it was understandable that there was controversy over mining, even if the forests were degraded, because there is not much forest left in Ghana.⁸² The FOE-Ghana Coalition further argued that allowing mining in forest reserves contravened various national policies and the principles underlining the establishment of forest reserves in Ghana as well as international commitments that the government had made, for example in the Convention to Combat Desertification and the CBD.

The government’s final argument, that the companies operating in forest reserves would be more strictly regulated, could be seen as a compromise between the position of the investors/Minerals Commission and that of the environmentalists/Forestry Commission (with the two sides ironically melded together at the Ministry level with the amalgamation of the Forestry Ministry and the Mining Ministry). However, members of the FOE-Ghana Coalition charged that, in the development of the *Environmental Guidelines* there had been no consultation with communities directly affected by mining or forestry or with civil society organizations.⁸³ The *Environmental Guidelines* listed twelve organizations as key contributors,⁸⁴ all of which are either representatives of the mining industry or govern-

⁷⁹“Minister Rekindles Mining in Forest Reserve Controversy,” *Public Agenda*, 8 September 2003.

⁸⁰ Author’s confidential interviews with a government official (#2), and non-governmental representatives (#3, #4, #8, & #11), Accra, June 2005.

⁸¹ Author’s confidential interview with a non-governmental representative (#11) Accra, June 2005.

⁸² Author’s confidential interview with a mining investor (#20), New Abirim, June 2005.

⁸³“National Coalition of Civil Society Groups Against Mining in Ghana’s Forest Reserves: A Presentation to the Ghanaian Media,” 31 March 2004, Old Press Centre, Accra, http://www.bicusa.org/Legacy/Coalition_press_statement_March04.pdf.

⁸⁴ Abosso Goldfields Ltd. (South Africa), Ashanti Goldfields Company Ltd. (South Africa), Birim Goldfields Inc. (Canada), Environmental Protection Agency, Forestry Commission, Forestry Services Division, Ghana Chamber of Mines, Knight Piesold Consulting (global consulting firm, with representatives from Australia and South Africa), Minerals Commission, Mines Department, Min-

ment agencies, and the funding for the project came entirely from foreign mining companies, leading one observer to conclude that: “the production of the document was funded by the mining industry and it cannot be trusted since it merely parrots the wishes of the mining industry.”⁸⁵ In any event, the *Environmental Guidelines* are non-binding, and provisions are frequently qualified by language such as “where practicable.” The companies operating in forest reserves would not be permitted to build any additional facilities within the reserves and would also be required to reforest the areas that they cleared.⁸⁶ However, according to one forestry official, the idea of restoring forests in Ghana is a myth: “You fell tropical trees and in place you plant grass and ornamental trees - you fell mahogany and plant cassia - it is not the same. After mining the soil is unable to sustain indigenous species.”⁸⁷ Officials from international organizations operating in Ghana were even more pessimistic; “Resources from mining will never be reinvested in forestry; rehabilitation doesn’t happen in Africa.”⁸⁸

While the mining-forest reserve debate has been effectively concluded by the government’s decision, and several companies have begun to advance their operations, some controversy remains (see Box 6.1).

Epilogue: Ghana’s New Mining Law

When it was drafted, the 1986 Minerals and Mining Law was considered very attractive for investors. However, times change and, in an attempt to regain the country’s competitiveness vis-à-vis other regimes, the Government of Ghana enacted a new Minerals and Mining Act (Act 703) in March 2006.

The key provisions which could have implications for the regulation of the environment are found in Sections 45 and 46, where investors are given the opportunity to sign ‘stability agreements’ and ‘development agreements’ with the

istry of Lands and Forestry, and the Wildlife Division.

⁸⁵“Golden Greed: Trouble Looms over Ghana’s Forest Reserves,” *World Rainforest Movement News Release*, n.d., <http://www.wrm.org.uy>.

⁸⁶“Only Proper Mining to Be Allowed in Forest Reserves,” *Ghana News Agency*, 13 June 2006.

⁸⁷ Author’s confidential interview with a government official (#13) Accra, June 2005.

⁸⁸ Author’s confidential interview with a representative of an international organization (#14) Accra, June 2005.

Box 6.1: The Akyem Project

Akyem is one of two projects owned by Newmont Mining Corporation and operated by its subsidiary Newmont Ghana Gold. The site is located approximately 125 km northwest of Accra. Part of the proposed open-pit mine area falls within the Ajenjua Bepo Forest Reserve. The Reserve is 569 ha and the 2.65 km open-pit mine would affect approximately 74 ha.

Newmont submitted an EIA for the project to the Ghana Environmental Protection Agency (EPA) in July 2004. The EPA had issues with the size of both the proposed open-pit mine and the waste rock dump, as well as Newmont's post-mining reclamation plans. The EPA asked the company to revise and resubmit its EIA, and suggested that the company consider backfilling in its reclamation plan.

Newmont claimed that the EPA recommendations would be too costly to implement and submitted a second draft of the EIA without addressing the size of the pit or waste rock pile, or the reclamation plan. At the time of writing, the dispute between the EPA and Newmont had not been resolved.

Sources:

"Dispute Over Newmont Proposed Mine at Akyem," *Public Agenda*, 16 October 2006.

"Newmont-Ghana Akyem Project Awaits EPA Approval," *Ghana News Agency*, 22 September 2006.

Website of Newmont Mining Corporation: <http://www.newmont.com>

government. These agreements are binding and are subject to international arbitration. A stability agreement ensures that:

the holder of the mining lease will not, for a period not exceeding fifteen years from the date of the agreement

- a. be adversely affected by any new enactment, orders, instruments or other actions made under a new enactment or changes to any enactment, orders, instruments that existed at the time of the stability agreement, or other actions taken under these that have the effect or purports to have the effect of imposing obligations upon the holder or applicant of the mining lease.⁸⁹

According to the Minister of Lands, Forestry and Mines at the time the law was enacted, Prof. Dominic Fobih, the ‘essence’ of this provision is to “protect the holder of a mining lease for a period not exceeding fifteen years from being adversely affected by future changes in laws that result in heavier financial burdens being imposed on the holder.”⁹⁰ In addition to a stability agreement, an investor may also enter into a development agreement, if the proposed investment will exceed US\$500 million. Such an agreement may contain provisions;

- a. relating to the circumstance or manner in which the Minister or the Commission will exercise a discretion conferred by or under this Act;
- b. relating to the mineral right or operations to be conducted under the mining lease;
- c. on stability terms as provided under section 45;
- d. *relating to environmental issues and obligations of the holder to safeguard the environment in accordance with this Act or other enactment;* and
- e. dealing with the settlement of disputes.⁹¹

A former Minister of Mines, Cecilia Bannerman, has stated that stability and development agreements “are mutually beneficial to investors and government as

⁸⁹ Ghana Minerals and Mining Act, at Section 45.

⁹⁰ Memorandum to the Draft Minerals and Mining Bill, 17 May 2005.

⁹¹ Ghana Minerals and Mining Act, at Section 46, emphasis added

they enable both parties to negotiate and agree on specified commitments and expectations.”⁹² The Ghana National Coalition on Mining (a group of organizations, communities, and individuals) is not convinced of this and strongly opposed the inclusion of stability or development agreements in the new Bill.⁹³

The next step for Ghana is to develop a model stability agreement. UNCTAD has recommended that this model be drafted in close consultation with industry and Parliament and suggests that the stability agreements of Chile and Peru would provide useful models (see Section 4.1.5).⁹⁴

6.1.3 Open-Pit Mining in Costa Rica

Two cases in Costa Rica are presented in this chapter. The first case involves a Canadian company that held a mineral exploration license in the country. In 2002, the Costa Rican government placed a moratorium on oil and gas exploration and open-pit mining. The Canadian mining company’s concession was not directly affected by the moratorium, but the company faced difficulty in the approval of its EIA. The company threatened to take the government to arbitration under the terms of the Canada-Costa Rica BIT, but was eventually permitted to proceed with mine development.

Background

In the late 1990s, Placer Dome Inc. of Canada explored for minerals on two properties in the far northwest corner of Costa Rica, near the Nicaraguan border.⁹⁵ Subsequently, these properties were acquired by Lyon Lake Mines Ltd., another Canadian company. In June 2000, Lyon Lake sold the rights to Vannessa Ventures, also incorporated in Canada.⁹⁶ The Crucitas project developed by Vannessa

⁹²Speech by Cecilia Bannerman, Ghana Minister of Mines, at the Conference of Montreal’s CIDA/IDRC International Forum Bringing the Best of the Private Sector to Development, 7 June 2004, http://www.idrc.ca/en/ev-61467-201-1-DO_TOPIC.html.

⁹³Memorandum on the Minerals and Mining Bill 2005, Submitted by the National Coalition on Mining to the Select Parliamentary Committee on Mines and Minerals, 8 June 2005.

⁹⁴UNCTAD/Japan Bank for International Cooperation 2006, at 21.

⁹⁵Doan 1998, at 1.

⁹⁶Velasco 2000, at 2.

consisted of 10 gold mining concessions covering an area of 176 square km.⁹⁷ Vannessa set up a subsidiary in the country, Industrias Infinito, S.A., submitted a feasibility report to the government in 2001 and received an exploitation permit in 2002, only days before a presidential election.⁹⁸

Oil and mining were hot campaign issues in the elections. All three of the leading candidates for office voiced their opposition to oil exploration in the country.⁹⁹ Abel Pacheco was elected in a close fought race, and in his inaugural address in May, he declared “peace with nature.” On Earth Day, he placed a moratorium on future oil and gas exploration as well as on large-scale open-pit mining projects.

Assuming that it would not be retroactively affected by the moratorium, Vannessa Ventures continued with the development of its project. The company contracted a Costa Rican consulting company to produce an EIA, and submitted it to country’s environmental agency (SETENA) in March 2002.¹⁰⁰ In August of that year, the Sala IV ruled on an appeal of the open-pit mining moratorium brought by Franz Ulloa, a representative of the Costa Rican Chamber of Mines. While the court upheld the moratorium, it affirmed the legality of concessions which were issued before the moratorium was put in place. The Environment Minister said that he would respect the decision, but also indicated that the government was ill-equipped to properly regulate and monitor large scale gold mines.¹⁰¹

The Conflict

Vannessa Ventures was confident that its mining licence was valid, based on the court decision, but it still faced a second hurdle: the approval of its EIA. In March 2003, a year after it had submitted the EIA, Vannessa filed an injunction to obtain a resolution on its approval or rejection. SETENA responded that the EIA was below standards and would not be approved. Vannessa subsequently filed an appeal

⁹⁷“Multi-Million Ounce Crucitas Gold Project Acquired,” *Vannessa Ventures News Release*, 17 May 2000, <http://www.vannessaventures.com>.

⁹⁸“Vannessa Advances Multi-Million Ounce Crucitas Gold Project,” *Vannessa Ventures News Release*, 22 January 2002, <http://www.vannessaventures.com>.

⁹⁹“Texas Oil a Slippery Issue in Costa Rica,” *CNN*, 5 February 2002.

¹⁰⁰“Vannessa Submits Crucitas Environmental Impact Study,” *Vannessa Ventures News Release*, 19 March 2002, <http://www.vannessaventures.com>.

¹⁰¹“High Court Gives Go-Ahead to Open-Pit Mine in North,” *Tico Times*, 25 October 2002.

with SETENA and requested that the Supreme Court review the decision.

The company declared that “the political environment that manifests itself in the declarations and actions of the President and Minister may have involuntarily influenced the legal and administrative process and resulted in unfair treatment of Infinito and its shareholders.”¹⁰² As a result, the company felt it that the principles of fairness, transparency, and non-discrimination, found in the Canada-Costa Rica Foreign Investment Promotion and Protection Agreement (FIPA),¹⁰³ had been violated.¹⁰⁴ The definition of investment under the FIPA covers “rights, conferred by law or under contract, to undertake any economic and commercial activity, including any rights to search for, cultivate, extract or exploit natural resources.”¹⁰⁵ The company also suggested that they had been discriminated against: “The negative viewpoints of the President and the moratorium against mining singles out open pit gold mining and excludes non-metallic mines altogether.”¹⁰⁶ Erich Rauguth, a senior mining consultant for Vanessa further stated that “[i]n reality we’ve been expropriated.”¹⁰⁷ The company noted in a news release that if it proceeded with international arbitration under the FIPA, “[e]ffective compensation would be based on the loss of return on investment that can reasonably be expected to materialize,” which Vanessa estimated at the time to be approximately US\$200 million.¹⁰⁸

Despite its bold statements, the company continued to pursue a response from SETENA on its appeal and took the issue to the local courts. The Sala IV found in their favour, requiring SETENA to respond to Vanessa’s appeal within five days.¹⁰⁹ The permitting process thereafter recommenced and in March 2004 the company appointed a technical commission to deal with additional issues raised by SETENA.¹¹⁰

¹⁰² *Ibid.*

¹⁰³ FIPA is the Canadian nomenclature for a BIT

¹⁰⁴ Agreement between the Government of Canada and the Government of the Republic of Costa Rica for the Promotion and Protection of Investments, 18 March 1998, San José.

¹⁰⁵ *Ibid.*, at Art. 1(g)(vi).

¹⁰⁶ “Crucitas Update,” *Vanessa Ventures News Release*, 14 April 2003, <http://www.vanessaventures.com>.

¹⁰⁷ “High Court Sides with Gold Mining Company,” *Tico Times*, 13 June 2003.

¹⁰⁸ *Ibid.*

¹⁰⁹ *Ibid.*

¹¹⁰ “Vanessa Ventures Updates Shareholders on its Activities,” *Vanessa Ventures News Release*, 26

In late 2004, environmentalists brought a case to the country's Constitutional Court, arguing that Vannessa was awarded its Exploitation Permit prior to receiving the required environmental approvals and that, as such, it should be annulled.¹¹¹ In December 2004, the court upheld the injunction, finding that the mining concession was in violation of the Central American Biodiversity Agreement and Article 50 (on the right to a healthy environment) of Costa Rica's Constitution.¹¹² The court ordered the state to pay costs, damages and compensation to the permit holder, but, to the confusion of Vannessa, apparently stated that the EIA process should move ahead. The company once again began openly discussing the option of international arbitration. John Morgan, president of Vannessa Ventures, explained why the company was not going to give up without a fight: "These projects are not that easy to find. When you look at whether we should persevere with these existing projects versus the other option of going out and trying to find another million ounce project, I'd take the former."¹¹³

In April 2005, the company asked the Constitutional Court to reconsider, clarify, and add to its ruling. Vannessa also filed a request to advance the international arbitration process with ICSID in July 2005. In a news release, the company stated that it sought restitution of its contractual rights and US\$5 million in legal and administrative costs. In lieu of restitution it sought lost profits of US\$240 million, plus US\$36 million in expenses and compound interest.¹¹⁴ The company made it clear that it was advancing the arbitration process in order to protect its claim under the time requirements of the FIPA, and that it would halt the process if SETENA provided approval of the EIA in the interim.¹¹⁵

April 2004, <http://www.vannessaventures.com>.

¹¹¹"Clarification of Supreme Court Decision on Crucitas Concession," *Vannessa Ventures News Release*, 5 December 2006, <http://www.vannessaventures.com>.

¹¹²"Court Annuls Gold Mining Concession," *Associated Press*, 12 December 2004.

¹¹³"Vannessa to Seek International Arbitration if Necessary," *Business News Americas*, 24 January 2005.

¹¹⁴"Vannessa Updated Crucitas Developments," *Vannessa Ventures News Release*, 22 July 2005, <http://www.vannessaventures.com>.

¹¹⁵*Ibid.*

Outcome

In September 2005, SETENA approved the EIA for the company, which could thereafter proceed with mine development.¹¹⁶ Industrias Infinito CEO Jesus Carvajal noted that the arbitration request to ICSID had helped Vanessa's case, stating that, "[t]his kind of pressure helped SETENA resolve the issue."¹¹⁷ The company reported that the approval of the EIA was "sufficient reason for the investor Vanessa Ventures, to consider the withdrawal of the arbitration presented before the [ICSID]."¹¹⁸

As an aside, it is interesting to note that the US and Costa Rica have negotiated a 'Side-Letter' to CAFTA-DR, which states that:

A nondiscriminatory indefinite moratorium on strip or open pit mining activities declared in the territory of Costa Rica shall not be deemed to be a non-conforming measure subject to the disciplines of Chapter Ten (Investment) or Eleven (Cross-Border Trade in Services).¹¹⁹

6.1.4 Offshore Oil Exploration in Costa Rica

The second case in Costa Rica involves an American oil company that held several land and offshore concessions in the country. The oil company's land concessions were annulled and it encountered problems in the approval of its EIA for the offshore concessions. This latter issue led to a conflict with the government and a filing to initiate investment arbitration under the terms of a state contract. The company eventually withdrew its arbitration request.

¹¹⁶"Crucitas Environmental Submission Approved," *Vanessa Ventures News Release*, 1 September 2005, <http://www.vanessaventures.com>.

¹¹⁷"Vanessa Secures Crucitas Enviro Permit," *Business News Americas*, 1 September 2005.

¹¹⁸"Mining Company Considers Withdrawal of International Arbitration," *Infinto News Release*, 2 September 2005, <http://infinto.co.cr>.

¹¹⁹Letter from United States Trade Representative Robert B. Zoellick to Costa Rica Minister of Foreign Trade Alberto Trejos, 28 May 2004, <http://www.ustr.gov>.

Background

In 1994, the Government of Costa Rica passed a Hydrocarbons Law as a part of a series of measures designed to implement a structural adjustment program. This law opened Costa Rica to foreign interests in oil and gas exploration. In 1997, the Ministry of Environment and Energy (MINAE) opened a round of bidding for oil and gas exploration concession blocks on land and offshore. In 1998, MKJ Xploration, a Louisiana-based company, acquired four concession blocks - two on land and two offshore.¹²⁰ Texas-based Harken Energy later purchased an eighty percent stake in the project under the subsidiary Harken Costa Rica Holdings (collectively 'Harken'). In 1999, protests began over the seismic tests that were being carried out in one of Harken's offshore concessions. Environmentalists expressed alarm over the potential impacts on marine life, and noted that wildlife reserves existed close by, including two sites registered under the Ramsar Convention on Wetlands.¹²¹ Fisherman and members of the tourist industry also voiced concerns about the impacts that oil exploration could have on their livelihoods.¹²²

Meanwhile, communities in the area of the land concessions filed a petition with the country's Constitutional Court, claiming that the bidding process had been flawed as there had been no prior consultation with them.¹²³ In 2000, the Constitutional Court ruled in favour of the petitioners, citing irregularities in the bidding process and a lack of public consultation.¹²⁴ The decision annulled Harken's concessions and called on the government to consult with indigenous communities.¹²⁵ Opposition groups, which had banded together under the Acción de Ludio Anti-Petrolera (ADELA), celebrated the decision; however, Harken maintained that the project was still viable as the Court had not made a decision on the validity of oil exploration, but only on the way that the contract

¹²⁰"The Case of Oil Exploration in the Caribbean off Costa Rica: Legal Background," *Environmental Law Alliance Worldwide*, n.d., <http://www.elaw.org>.

¹²¹"Oil Exploration Protested," *Tico Times*, 10 December 1999; "Costa Rica Rejects Oil Exploration Near Ramsar Sites," *Ramsar News Release*, 3 March 2002, <http://www.ramsar.org>.

¹²²"Oil Drilling Plans Denounced," *Tico Times*, 1 September 2001.

¹²³"The Case of Oil Exploration in the Caribbean off Costa Rica: Legal Background," *Environmental Law Alliance Worldwide*, n.d., <http://www.elaw.org>.

¹²⁴"Oil Drilling Plans Denounced," *Tico Times*, 1 September 2001.

¹²⁵"Court Orders Halt to Oil Drilling," *Tico Times*, 14 September 2000.

had been awarded.¹²⁶ The company filed a motion for relief, claiming that it had been denied the opportunity to make its case heard before the Court, and subsequently the Court amended its decision so that only the two land concession blocks held by Harken were annulled, leaving the marine concession blocks unaffected.¹²⁷ The company welcomed this decision, as it had conducted the bulk of exploration work in the offshore blocks, and it later decided to give up its contractual rights in the land blocks rather than proceed with consultations with the indigenous communities.¹²⁸

The Conflict

While Harken's offshore concessions had not been annulled, the company still had to obtain approval for its EIA. In 2001, SETENA outlined numerous legal and technical elements that were missing from Harken's EIA. These included the failure to address the potential effects of an oil spill and to provide measures for containment in the event of a spill.¹²⁹ Environmentalists sought the assistance of the International Union for the Conservation of Nature (IUCN), who in turn hired two independent experts to review the EIA. The consultants also reviewed an Addendum to the EIA which the company produced in response to SETENA's concerns, and found that it failed to adequately address the potential scope and cumulative effects of oil exploration in the area.¹³⁰

In February 2002, the Constitutional Court ruled that the part of the Hydrocarbons Law relating to the EIA process was not in compliance with Article 50 of the Constitution guaranteeing the right to a healthy and ecologically balanced environment. The main problem with the Law was that approval of a comprehensive EIA was not required before a contract was signed.¹³¹ The court also noted that SETENA was ill-equipped to deal with the review of these studies. A push to repeal the law entirely began, which the CEO of Harken Costa Rica Holdings

¹²⁶“Oil Firm: Project Not Dead Yet,” *Tico Times*, 29 September 2000.

¹²⁷“Oil Firm Faces Deadline to Clarify Report,” *Tico Times*, 2 February 2001.

¹²⁸“Oil Firm Out of Indian Land,” *Tico Times*, 23 March 2001.

¹²⁹“Oil Firm Faces Deadline to Clarify Report,” *Tico Times*, 2 February 2001.

¹³⁰*Ibid.*

¹³¹“High Court Dampens Oil Plans,” *Tico Times*, 15 February 2002.

argued would “send a terrible, tragic and devastating message to the international business community.”¹³²

In late February, SETENA made its final decision, providing 55 reasons for rejecting the Harken’s EIA. The reasons provided by SETENA relied heavily on the precautionary principle, international agreements such as RAMSAR, the Constitutional Court decisions, the lack of resources in the country to deal with oil spills, and the deficiencies in the company’s application. Harken maintained that the decision to reject the EIA was based on a lack of understanding about the technology that would be employed in the operation and filed an appeal.¹³³

In October 2003, the company filed an arbitration request with ICSID. Harken claimed it had lost US\$9-\$12 million in exploration activity and costs related to administrative and legal procedures, but the company sought US\$57 billion in damages and lost future profits. President Paceco flatly refused to consent to arbitration and pointed out that Harken’s contract required the company to exhaust local remedies.¹³⁴ Furthermore, he argued that the company had not met its environmental requirements, which was ground for termination of the contract. On the other hand, Harken Costa Rica Holding’s CEO suggested that SETENA’s decision had been politically motivated, that a fair hearing in Costa Rica would be impossible, and that the company “would prefer to reserve the decision to the panel of unbiased and fair international arbitrators.”¹³⁵ However, a representative of the NGO OilWatch Costa Rica put forth that the threat of arbitration was “a bluff intended to give the company a stronger negotiating position,” and a lobbyist of the company admitted that the company would be willing to back down for a US\$10 million settlement.¹³⁶

¹³²“Hydrocarbons Law Stirs Furor,” *Tico Times*, 22 February 2002

¹³³Harken Energy Corporation, SEC Form S-3 (Registration Statement for Securities Offered Pursuant to a Transaction), Filed 3 June 2002, <http://www.secinfo.com>.

¹³⁴“The Threat to the Environment from the Central America Free Trade Agreement (CAFTA): The case of Harken Costa Rica Holdings and Offshore Oil,” *Natural Resources Defense Council (NRDC) and Friends of the Earth US (FOE-US) Fact Sheet*, n.d., <http://www.foe.org/camps/intl/harken.pdf>.

¹³⁵“Pacheo Stands Firm Against Oil Drilling,” *Tico Times*, 3 October 2003; “U.S. Oil Company Withdraws Request,” *Tico Times*, 10 October 2003.

¹³⁶“Pacheo Stands Firm Against Oil Drilling,” *Tico Times*, 3 October 2003.

Outcome

Only seventeen days after the initial request to ICSID, Harken dropped the case as a “good faith” act and sought negotiations.¹³⁷ President Pacheco called the withdrawal a “triumph for reason and justice.”¹³⁸ Negotiations ensued, and at one point Costa Rica was apparently willing to pay Harken between US\$3 and \$11 million, as this was “cheaper than being sued” and “preferable to facing retaliatory sanctions from the US government.”¹³⁹ In the end, the negotiations were unsuccessful and in a resolution signed by the President in 2005, the government of Costa Rica formally canceled Harken’s concession contract.¹⁴⁰

For many American NGOs, the Harken case became a symbol of everything that was wrong with the CAFTA-DR. Friends of the Earth US (FOE-US), Oxfam America, and the Natural Resources Defense Council (NRDC) wrote to the US Congress in 2004 urging them to oppose the agreement, suggesting that the Harken case demonstrated the risks of investment protection to the environment and development.¹⁴¹ While Costa Rica had been able to refuse international arbitration on the basis of the terms of its contract with Harken, the groups argued that under CAFTA-DR the government would have been forced into international arbitration.¹⁴²

6.1.5 Analysis

The section assesses the role that the threat of arbitration played in the outcome of each conflict. It also compares the factors that contributed to the efficacy of the threat of arbitration in each case.

¹³⁷“Harken Stopped Arbitration,” *La Nacion*, 4 October 2003.

¹³⁸“U.S. Oil Company Withdraws Request,” *Tico Times*, 10 October 2003.

¹³⁹“Government, Harken to Negotiate Settlement,” *Business News Americas*, 13 January 2004.

¹⁴⁰“Government Cancels Harken Exploration Concession,” *Business News Americas*, 3 March 2005.

¹⁴¹Letter from FOE-US, Oxfam America, and NRDC to US Congress Re: Harken Costa Rica Example Demonstrates the Risks Posed by the Central American Free Trade Agreement for Environment and Development, 31 March 2004, http://www.citizenstrade.org/pdf/foe_harkencongletter_april2004.pdf.

¹⁴²*Ibid.*

The Threat of Arbitration

The role that a threat to arbitrate plays in the outcome of a conflict depends, first of all, on the credibility of the threat. However, this is not always a straightforward issue. There were clearly differing opinions in Indonesia on whether the CoWs, as *lex specialis*, were exempt from the Forestry law. One interviewee in Ghana suggested that many observers were not convinced that the threat of arbitration was serious in the forest reserves case.¹⁴³ In Costa Rica the threat from Harken to arbitrate was taken by the government to be a hollow one, as the contract stipulated a requirement to exhaust local remedies, and no BIT or regional investment agreement was (yet) in place. If the CAFTA-DR had already been in place, it is possible that the outcome of the conflict might have been different. Indeed, the outcome was different in the Vannessa Ventures conflict, where the threat of arbitration could be backed up by the Canada-Costa Rica FIPA.

A second issue is the confidence (or lack thereof) of a government that it could win if it was taken to arbitration. NGOs in both Ghana and Indonesia expressed considerable confidence that their governments would be successful in the event of an arbitration. In Ghana they argued that it was clear in the country's laws that mining in forest reserves was not permitted, and that therefore both the former government and the companies were at fault for breaching the law.¹⁴⁴ In Indonesia, NGOs argued that the contracts stipulated that mining companies must comply with environmental law.¹⁴⁵ However, in both cases the governments appeared less confident of a successful outcome.

The threat of arbitration appeared to have the greatest influence in Indonesia. After having done little to resolve the conflict for a quite some time, the government responded quite dramatically with the Perpu following the threat of arbitration. Furthermore, the fact that the companies that threatened arbitration were also the ones which were exempted from the law is unlikely to be mere coincidence.¹⁴⁶ The need to avoid arbitration was also mentioned by the Parliament in their dis-

¹⁴³ Author's confidential interviews with a non-governmental representative (#4), Accra, June 2005.

¹⁴⁴ *Ibid.*

¹⁴⁵ "Mining Industry Threatens Indonesia with International Arbitration," *WALHI and JATAM News Release*, 4 April 2002, <http://www.jatam.org>.

¹⁴⁶ Gross 2003, at 895.

cussions on the issue and by the judges in the Constitutional Court decision.¹⁴⁷ Furthermore, the fact that the government subsequently tried to move away from the CoW system in the drafting of a new mineral law, and specifically tried to remove recourse to international arbitration for mineral investors, suggests that the threat of a formal dispute was a serious concern of the administration (although it also relates to efforts to decentralize oversight of mineral projects).

In Ghana, the role that the threat to arbitrate played in the outcome of the conflict is less clear-cut, particularly in light of a recent development. Following the effective resolution of the mining in reserves debate, reports began to emerge that Alcoa, a multinational bauxite mining company, was seeking access to explore in the Atewa forest reserve.¹⁴⁸ It was later confirmed that the government had permitted the company to undertake exploration activities there.¹⁴⁹ This development suggests that the claim used by the government that its hands were tied by its obligations to the initial five mining companies was an excuse used to quell domestic and international opposition to the decision. It appears evident that the Minerals Commission is keen to move ahead with more projects in forest reserves despite the objections of the Forestry Commission and the concerns of the Ghana EPA, and that it has benefited from the threat of arbitration in this regard.

Finally, in Costa Rica, the differing treatment of Harken and Vanessa Ventures appears to correspond directly with the government's assessment of the credibility of each company's threat to arbitrate, suggesting that a threat does have considerable influence when it has a firm basis. However, there are also alternative explanations for the discrepancy in the treatment of these two investors (see below).

Factors that Contributed to the Efficacy of the Threat

The available evidence suggests that governments faced with a threat of arbitration are primarily concerned with the financial consequences of losing in arbitration as well as the reputational consequences of participating in arbitration. Additionally, it would appear that divisions within a government can contribute to the efficacy of

¹⁴⁷ Author's confidential interview with a nongovernmental representative (#7), Jakarta, July 2005.

¹⁴⁸ "Price Tag on Atewa Forest As Alcoa Eyes Bauxite," *Public Agenda*, 7 August 2006.

¹⁴⁹ "Minister Commends Bauxite Exploration at Atiwa," *Ghana News Agency*, 11 September 2006.

a threat. Finally, a threat of arbitration may be more disquieting for a government that has had a negative experience with the process in a previous case.

In terms of financial concerns, it is the very substantial claims of compensation that are particularly troubling for governments. The Indonesian Minister for Environment, Nabeli Makarim, stated that the decision to allow the 13 companies to mine in protection forests was “hard luck”¹⁵⁰ and only taken to avoid paying compensation for which funds were not available.¹⁵¹ The Indonesian government reportedly received legal advice that it could be sued for up to US\$31 billion.¹⁵² While that is a very large sum compared to any of the awards reviewed in Chapter 5, one has to remember that there were several companies involved in the conflict. For any country such a sum would be significant, but particularly for a country with a gross domestic product of US\$364 billion (making the potential award worth 8.5% of GDP). While it is clear from Chapter 5 that investors are usually not awarded as much as they seek, even if this estimate were double or triple what could foreseeable awarded, the cost would still be considerable. The sum of more than US\$275 million in compensation claimed by Vanessa Ventures would also surely have been a daunting figure for the Costa Rican government, although obviously less so than the US\$57 billion claimed by Harken. It should be noted that Costa Rica’s annual GDP at the time was only about US\$17 billion, and the government budget about US\$5 billion. There were no reports in Ghana that suggested a possible figure for the amount of compensation that the government might be expected to pay, but it was implied that there had been significant investments made by the mining companies.¹⁵³ One publication in Ghana argued that “it is better for the government to refund the money to the companies, rather than giving out concessions for them to destroy the remaining forest reserves in the name of investment.”¹⁵⁴ However, others suggested that the government simply

¹⁵⁰“No More Mining Permits in Protected Forests,” *MiningIndo*, 16 March 2004.

¹⁵¹“State Minister for Environment: Issuing Mining Licenses for 13 Companies was a Mistake,” *Tempo Interactive*, 15 March 2004.

¹⁵²“Indonesian Government Can’t Bury Mining Conflicts,” *Asia Times*, 10 January 2004. Other analysts have estimated the potential costs and compensation payments closer to US\$22.8 billion.

¹⁵³“Only Proper Mining to be Allowed in Forest Reserves,” *Ghana News Agency*, 13 June 2006.

¹⁵⁴“Whither the Mining Industry?” *Public Agenda*, 12 May 2003.

could not afford to do so.¹⁵⁵

In terms of reputational concerns, it should be noted that these will exist even in the absence of investment protection; a conflict can be detrimental to the investment climate whether the investor is protected by a contract or IIA or not. However, the elevation of a conflict to formal dispute resolution is considered to be particularly damaging to a country's image in the eyes of foreign investors.¹⁵⁶ Concerns about reputation were particularly evident in Ghana and Indonesia. Indonesia's mineral sector ranked 27th out of 35 countries assessed for 'attractiveness' in a 2001/2002 industry survey.¹⁵⁷ The low attractiveness ranking is not based on resource limitations (minerals are in abundance in the country), but rather relate to problems in the investment climate.¹⁵⁸ The mining in protected forests debate certainly affected investors perceptions of the country. Mélanie *et al.* suggest that:

The conflict between provisions of the Forestry Law of 1999 and the mining industry has probably created more uncertainty for investors in Indonesia's mining sector than any other legal or regulatory provision and is one of the key reasons for the decline in investment activity in recent years.¹⁵⁹

Hence, the desire to keep existing mineral investments and attract further ones was a likely factor in the Indonesian government's decision to issue the Perpu. Even greater concern about this issue was evident in Ghana, a country that is generally perceived as quite 'investor-friendly'. It has been suggested that the initial indecision over whether to open the forest reserves to mining contributed to dwindling investment in the country.¹⁶⁰ In addition, at least one company that was seeking a concession inside a reserve made it clear that its other potential investments in the country would be impacted by the government's decision.¹⁶¹ Several interviewees

¹⁵⁵ Author's confidential interviews with government official (#7), and an academic (#9), Accra, June 2005.

¹⁵⁶ Otto and Cordes 2002, at V-16.

¹⁵⁷ "Indonesian Government Can't Bury Mining Conflicts," *Asia Times*, 10 January 2004.

¹⁵⁸ PricewaterhouseCoopers 2004.

¹⁵⁹ Mélanie *et al.* 2005, at 13.

¹⁶⁰ "Ghana Lures Miners with New Laws Opening Forests," *Reuters*, 20 February 2003.

¹⁶¹ When Newmont found gold in two locations, one inside a reserve, it was reported that the company "wants both concessions or nothing." See "Ghana's Gold Dilemma," *BBC News*, 4 February 2003.

suggested that the government feared arbitration not because they feared losing, but because they feared the impact that denying the leases and proceeding to arbitration would have on their reputation with foreign investors.¹⁶² In contrast, Costa Rica was obviously not concerned about lost future investments in the extractive industries. Unlike the bans in Ghana and Indonesia, the moratorium in Costa Rica did not apply only to certain areas, but to the entire country. This is clearly a part of Costa Rica's broader strategy to focus on tourism, particularly eco-tourism, as a source of economic development, rather than the exploitation of natural resources.

In terms of internal government politics, it is evident that there are often disagreements on how conflicts with investors should be resolved, and how threats to arbitrate should be dealt with. In both the Ghanaian and Indonesian cases, ministries responsible for mining and those responsible for forests and environment were pitted against one another. This clearly would make the position of the government much weaker in an arbitration, and thus the threat of arbitration more potent. While the government would have to present a united front if it proceeded in arbitration, an investor would be able to refer to statements previously made by its supporters in government. Ministries that are closely tied with foreign investors often have more clout in the government, and can put substantial pressure on government leaders and legislatures. They also have more knowledge of contracts and IIAs, which they can exploit to their advantage.

Finally, it is evident at least in the Indonesian case that the government's past experience with international arbitration may have been an important factor in the outcome of the conflict. According to several observers, the government had been "burned" in previous arbitrations and was not eager to try their luck again.¹⁶³ *The Jakarta Post*, in an article on the mining in forests case, noted that government officials frequently referred to the *Karaha Bodas* dispute in particular (see Box 6.2 for further discussion of this dispute).

¹⁶² Author's confidential interviews with a non-governmental representative (#4), a representative of an international organizations(#6), a government official (#13), and an academic (#18), Accra and Kumasi, June 2005.

¹⁶³ Author's confidential interviews with foreign embassy officials (#4, #10), a nongovernmental representative (#7), and a mining investor (#9), Jakarta, July 2005.

Box 6.2: The Karaha Bodas Dispute

In the mid-1990s, two American companies - Florida Power & Light and Caithness Energy - formed Karaha Bodas Company, incorporated in the Cayman Islands. Karaha Bodas entered into a joint operation contract with the state-owned oil company Pertamina to develop a geothermal project in West Java. When the Asian Currency Crisis hit in 1997, the project was postponed. By the spring of 1998, the company had filed for arbitration under UNCITRAL Rules, as provided for in their contract. The tribunal found that Pertamina was liable for losses incurred by Karaha Bodas as a result of the economic crisis, and awarded the company US \$261.1 million in damages, including sunk costs and lost profits.

Pertamina attempted, unsuccessfully, to have the award set aside in the Swiss Supreme Court (Switzerland was the seat of the tribunal). Karaha Bodas, for its part, began actions to enforce the award against Pertamina's assets in foreign countries. Pertamina made several attempts in Indonesian and foreign courts to block the enforcement of the award, but in March 2007 it finally abandoned its efforts and agreed to pay the company.

Sources:

Chung 2007

Wells and Ahmed 2007

Website of the US Embassy in Jakarta: <http://www.usembassyjakarta.org>

Alternative Scenarios

While it would appear that there is substantial evidence that the threat to arbitrate played a significant role in the outcome of the cases discussed, other explanations cannot be ruled out. For example, diplomatic pressure on governments, applied by the home state of the investors, could have also contributed to the outcome in each case. Indonesia was apparently subject to informal pressure applied by the home governments of the investors through their embassies.¹⁶⁴ Vannessa Ventures enlisted the support of the Canadian Embassy “to encourage transparency and due process from the Costa Rican government,”¹⁶⁵ and there were reports that the US Embassy had become involved in the Harken case. Although the US Ambassador to Costa Rica maintained that he was only assisting the company in so far as to ensure that it was treated fairly by the government, activists remained suspicious.¹⁶⁶ Their suspicions were fueled by the fact that US President George W. Bush was a former Harken board member. However, others believed that the US pressure was actually on Harken to withdraw its arbitration request, as it could have complicated the negotiations for the CAFTA-DR.¹⁶⁷ Thus, the discrepancy in the treatment of Harken and Vannessa Ventures might be explained by the fact that Canada urged the government to resolve the conflict, while the US instead might have pressured the investor to drop its arbitration request.

One can also not rule out the possibility that corruption was involved in the outcome of these conflicts; it was certainly alleged to be a factor in the Indonesian case.

6.2 Conflicts Over Domestic Court Proceedings

The two cases discussed in this section concern domestic court proceedings. More specifically, each case relates to environmental liability claims brought by govern-

¹⁶⁴See, e.g., “Indonesia: Mining and Forestry (Question No.1662),” *Australian Senate Official Hansard* No. 11, 2003, 15356-57, <http://parlinfoweb.aph.gov.au>.

¹⁶⁵“Crucitas Update,” *Vannessa Ventures News Release*, 14 April 2003, <http://www.vannessaventures.com>.

¹⁶⁶“Costa Rica Just Says No to Oil Development,” *Environmental News Network*, 20 September 2002.

¹⁶⁷“Pacheco Wins One With Reversal by Harken Energy,” *A.M. Costa Rica*, 6 October 2003.

ment ministries or individuals against foreign investors.

6.2.1 Liability for Marine Pollution in Buyat Bay, Indonesia

This case concerns a civil liability suit brought by the Indonesian Ministry of the Environment against an American mining company for allegedly breaching environmental law in the course of its operations. The suit was brought in an Indonesian court but was dismissed because the court found that all disputes between the government and the investor should be resolved through investment arbitration, as stipulated in the company's contract.

Background

Newmont Mining Corporation's 80%-owned subsidiary, PT Newmont Minahasa Raya, operated the Mesel Gold Mine in North Sulawesi, Indonesia, from 1996 to 2004, when it was closed due to depletion of gold ore at the mine. In that period, the company was authorized by the Indonesian government to use submarine placement of tailings.¹⁶⁸ The tailings were placed on the seabed at a depth of 82 meters via a pipeline that rested on the seabed. The pipeline extended 900 meters into the sea at a location known as Buyat Bay.¹⁶⁹ The tailings contained insoluble mercury and arsenic compounds. Submarine tailings disposal is effectively illegal in Canada, the US, and Australia.¹⁷⁰

Local communities and NGOs claimed that the tailings had polluted Buyat Bay and were responsible for adverse health effects experienced by local residents. Subsequently several studies were carried out, commissioned by both the Indonesian government and Newmont. Local police found elevated levels of arsenic and mercury in the water; however a World Health Organization (WHO) study found the levels to be within normal parameters.¹⁷¹ Finally, a study by the

¹⁶⁸Tailings are finely ground rock from which minerals such as gold has been recovered.

¹⁶⁹"Buyat Bay: History and Status", *Newmont Brochure*, May 2006, <http://www.newmont.com>.

¹⁷⁰"Submarine Tailings Disposal," *Mineral Policy Institute Website*, <http://www.mpi.org.au>, accessed 4 January 2008.

¹⁷¹Mercury Pollution: Buyat & Totok Bay, North Sulawesi, Indonesia. Final Report. Prepared by Mineshi Sakamoto, Institute for Minamata Disease, Ministry of Environment Japan, for the World Health Organization Indonesia, 8 September 2004.

Indonesian Ministry of Environment found that the waste from the gold mine left high levels of arsenic and mercury in the sediment on the floor of the bay, which then entered bottom-feeding organisms known as benthos that provide food for fish.¹⁷² For its part, Newmont claimed that the arsenic was not the kind that would dissolve in water, and would not enter the food chain. Newmont admitted that it released 17 tons of waste mercury into the air and 16 tons into the water over five years, but argued that these releases were well within the range allowed under national law.¹⁷³ The Ministry of the Environment countered that the company had not been authorized to release that amount of waste.

The Conflict

On 9 March 2005, the Ministry of Environment filed a civil lawsuit against PT Newmont Minahasa Raya in the South Jakarta District Court, seeking US\$133.6 million in damages. The Ministry also filed separate criminal proceedings against the company, and its President Richard Ness, for the pollution of Buyat Bay. The Ministry stated that in the civil lawsuit it was seeking damages to pay for the restoration of the environment in Buyat Bay and the relocation of local residents, while the purpose of the criminal prosecution was to deter others from breaching the country's environmental laws.¹⁷⁴

According to the legal representation for Newmont, in filing the civil suit the Ministry had "not complied with the prevailing provisions under the Contract of Work," which "stipulates that all disputes between the parties will be settled by conciliation or arbitration in accordance with the international arbitration rules."¹⁷⁵ The company's attorney went on to say that Newmont would "have to consider filing for international arbitration to follow the CoW" and noted his confidence that the company would win both the court case and the arbitration, concluding that the Environment Ministry had "made a blunder."¹⁷⁶

¹⁷²"U.S. Mine to Pay Jakarta \$30 million to Settle Suit," *The New York Times*, 16 February 2006.

¹⁷³"Govt, Newmont Seek Amicable Deal," *The Jakarta Post*, 9 July 2005.

¹⁷⁴*Ibid.*

¹⁷⁵"Newmont to Submit Case to International Arbitration," *Newmont News Release*, 9 March 2005, <http://www.newmont.com>.

¹⁷⁶*Ibid.*

In October 2005, Newmont filed an objection to the court's jurisdiction, contending that the Indonesian government had previously agreed to resolve any disputes through conciliation or arbitration.¹⁷⁷ Prosecutors insisted that the dispute resolution clause in the contract was only applicable in business disputes, but not in a case of breach of environmental law.¹⁷⁸

Outcome

In November 2005, the Jakarta District Court dismissed the Ministry of Environment's civil claim against Newmont on the grounds that the parties had agreed, in the CoW, to settle disputes in investment arbitration. Newmont hailed the court ruling as well reasoned, with President Richard Ness stating that the verdict was both "fair" and "good for the investment climate."¹⁷⁹ Environmentalists urged the Ministry to appeal the decision, arguing that the court had erred in finding that a pollution case should be resolved in investment arbitration.¹⁸⁰ WALHI asserted that a provision in the Environment Law (23/1997) gave the government the right to sue companies for environmental damage and suggested that the court decision elevated commercial mining contracts over national law.¹⁸¹ WALHI later lodged its own civil lawsuit against the company.¹⁸²

On 16 February 2006, the government settled with Newmont for US\$30 million and entered into a 'Goodwill Agreement'. In the Agreement, the Indonesian government agreed that further scientific investigation into whether Newmont's operations had caused any adverse environmental impacts in Buyat Bay or adverse health impacts in local residents would be undertaken by an independent panel of six scientists over a period of up to ten years. Newmont agreed to the establishment of a charitable foundation to oversee the dispersal of the funds to

¹⁷⁷Newmont Mining Corporation Notes to Condensed Consolidated Financial Statements (Unaudited), SEC Form 10-Q, 27 July 2006, <http://sec.edgar-online.com>.

¹⁷⁸"Court dismisses civil suit against Newmont," *Jakarta Post*, 16 November 2005.

¹⁷⁹*Ibid.*

¹⁸⁰"Environmentalists Urge Indonesia to Appeal Court Ruling on Newmont Lawsuit," *Associated Free Press*, 17 November 2005.

¹⁸¹"WALHI Sues Newmont," *WALHI News Release*, 22 March 2007, <http://www.eng.walhi.or.id>.

¹⁸²*Ibid.*

support the scientific panel as well as other projects in the local community.¹⁸³ State Minister of the Environment, Rachmat Witoelar, when defending the settlement stated that: “If there’s someone who’s upset about the ruling, why don’t they ask the presiding judge [in the original civil suit]? The settlement occurred because the court dismissed our demand. I’ve suffered because the court trampled on me.”¹⁸⁴

Newmont and Richard Ness were acquitted of all criminal charges on 24 April 2007.¹⁸⁵

6.2.2 Liability for Oil Pollution in the Ecuadorian Amazon

In this case, an American oil company attempted to take the Government of Ecuador to arbitration to ensure that it would not be held liable for any compensation awarded to the claimants in a class action lawsuit. The lawsuit was brought by the residents of Ecuador’s Amazon region who had allegedly suffered from the impact of oil pollution. Ecuador challenged the arbitration and successfully blocked the proceedings in the courts of New York. The class action lawsuit, which was originally filed in the US but later refiled in Ecuador, was proceeding at the time of writing. While the company argued against the suit being tried in the US courts, it has recently suggested that the trial in Ecuador is unfair and that it amounts to a denial of justice, in contravention of international law.

Background

Kimerling remarks that the discovery of commercial quantities of oil in the Ecuadorian Amazon in the 1960s “was heralded as the salvation of Ecuador’s economy, the product that would, at last, pull the nation out of chronic poverty and ‘underdevelopment.’”¹⁸⁶ Texaco was one of the companies that first discovered oil in the region. The company began exploring for oil in Ecuador in 1964 under

¹⁸³“Buyat Bay: History and Status,” *Newmont Brochure*, May 2006, <http://www.newmont.com>.

¹⁸⁴“Rachmat Says \$30 Million Newmont Deal No Slap in the Face,” *The Jakarta Post*, 18 February 2006.

¹⁸⁵“Indonesian Court Clears U.S. Mining Firm,” *Associated Press*, 25 April 2007.

¹⁸⁶Kimerling 2006, at 414-5.

a subsidiary called Texaco Petroleum Company, often referred to as ‘TexPet’. In 1965 Texaco signed a joint operating agreement (JOA) with the Gulf Oil Company covering a block of land known as the Napo Concession.

In 1972, Ecuador’s military assumed control of the government and, in an effort to nationalize the state’s oil industry, issued Supreme Decree No. 430, which required both TexPet, and the Gulf Oil Company to agree to relinquish a substantial percentage of Napo Concession. In 1973, the government published Decree No. 925, which established a new contract for the concession.¹⁸⁷ The contract was signed by Ecuador, TexPet and Gulf Oil, and mandated that Compania Estatal Petrolera Ecuatoriana, a state-run oil company later renamed Petroecuador (which is the name that will be used hereafter in order to avoid confusion), be given the option to purchase a stake in the Napo Concession. The 1973 Contract did not contain an arbitration clause.¹⁸⁸

While the 1973 contract did not anticipate Petroecuador’s participation in the concession until 1977, the government sped up the process and in 1974 another contract was signed, giving Petroecuador 25% of Gulf Oil’s stake in the concession. This contract did not contain an arbitration clause, but stated that “[t]he totality of the activities that will develop in the Joint Operation will be regulated by an operating agreement entered into by the parties.”¹⁸⁹ Petroecuador subsequently assumed all Gulf Oil’s remaining interest in the concession in 1976.¹⁹⁰ From that point on, Petroecuador had a majority (62.5%) interest in the consortium, although Texaco remained the operational partner.¹⁹¹ Petroecuador never signed the 1965 JOA, and while negotiations were held for the development of a new JOA, they were never successfully concluded. In 1990, Texaco sold its

¹⁸⁷*The Republic of Ecuador and Petroecuador, Claimants, v. ChevronTexaco Corporation and Texaco Petroleum Company, Defendants, and ChevronTexaco Corporation and Texaco Petroleum Company, Counterclaim Plaintiffs, v. The Republic of Ecuador and Petroecuador, Counterclaim Defendants*, United States District Court, South District New York, 27 June 2005. Reproduced in 376 *Federal Supplement Second Series*, at 334. Subsequently referred to as ROE I.

¹⁸⁸*Ibid.*

¹⁸⁹Qtd. in *ibid.*, at 340.

¹⁹⁰“Chevron Warns Ecuador on BIT Claim as Contract and Environmental Disputes Persist,” *Investment Treaty News*, 26 July 2006.

¹⁹¹“Arbitration Proceedings,” *ChevronTexaco website*, <http://www.texaco.com/sitelets/ecuador>, accessed 4 January 2008.

interest in the concession to Petroecuador.¹⁹²

In the operation of the concession, Texaco used a controversial but cost-saving method of bringing a mixture of oil and water to the surface before separating the two, and leaving the water to run-off into rivers and streams.¹⁹³ According to one report Texaco intentionally dumped more than 19 billion gallons of toxic wastewater into the region and was responsible for 16.8 million gallons of crude oil spilling from the main pipeline into the forest.¹⁹⁴ The resulting ecological damage has been referred to as an “environmental disaster 30 times larger than the Exxon Valdez spill,” and the NGO Amazon Watch has estimated the clean-up bill at US\$6 billion.¹⁹⁵

In 1994, TexPet, Petroecuador, and Ecuador signed a Memorandum of Understanding, followed in 1995 by a contract, relating to the remediation of areas that had been polluted by oil operations. Under this settlement, TexPet agreed to perform specified environmental remedial work (for an estimated US\$40 million) in exchange for being released from liability for any claims by the Government of Ecuador or Petroecuador.¹⁹⁶ In 1998, following the remedial work, TexPet was released of liability for such claims.

The Conflict

In 1993, two class action lawsuits were filed against Texaco under the Alien Tort Claims Act in a federal court in New York on behalf of an estimated 30,000 Amazon residents.¹⁹⁷ The court determined that New York was not the most conve-

¹⁹²“ChevronTexaco and Texaco Petroleum company File Arbitration Claim to Enforce Petroecuador’s Obligations under Joint Operating Agreement,” *Chevron Texaco News Release*, 15 June 2004, <http://www.texaco.com/sitelets/ecuador>.

¹⁹³“Chevron Warns Ecuador on BIT Claim as Contract and Environmental Disputes Persist,” *Investment Treaty News*, 26 July 2006.

¹⁹⁴The 1993 report “Crudo Amaznico” (Amazon Crude) by the environmental lawyer Judith Kimerling is qtd. in “Chevron (CVX) in the Amazon: Oil Rights or Human Rights?” *Amnesty International USA website*, <http://www.amnestyusa.org>.

¹⁹⁵“Embattled Chevron Executive to be put Under Oath Today in \$6 billion Rainforest Lawsuit, Amazon Watch Says,” *PR Newswire*, 8 November 2006.

¹⁹⁶ROE I, at 341-2.

¹⁹⁷*Aguinda v. Texaco, Inc.*, United States Court of Appeals for the Second Circuit, 16 August 2002. Reproduced in 303 *Federal Reporter Third Series* (2002), at 470; *Jota v. Texaco, Inc.*, Court of

nient forum for the cases, which was confirmed by a US appeals court in 2002.¹⁹⁸ However, the judgment in the appeals court was subject to the condition that Texaco agree to submit to the jurisdiction of Ecuador's courts, and the claims were subsequently refiled in Ecuador. President Rafael Correa has publicly sided with the plaintiffs in their case.¹⁹⁹

On 11 June 2004, ChevronTexaco²⁰⁰ filed a claim with the American Arbitration Association (AAA) under the terms of the arbitration clause in the 1965 JOA. In the claim, the company asserted that Petroecuador is "responsible for all fees, costs and expenses incurred by ChevronTexaco and TexPet related to the pending litigation against the companies, including any final judgments that may be rendered against ChevronTexaco in Ecuador."²⁰¹ In ChevronTexaco's view, even though Petroecuador did not sign the 1965 JOA, it knowingly accepted benefits from the agreement and behaved as if the agreement controlled its relationship with TexPet. As such, the company argued that Petroecuador should be bound by the arbitration clause within the 1965 JOA.²⁰²

Ecuador subsequently filed a suit with the New York Supreme Court to stop the arbitration proceedings in the AAA. The case was later moved to the New York Southern District Court. Chevron filed a counterclaim, arguing that the company had been released from all liability by the 1995 remediation agreement. In response, Ecuador argued that Texaco concealed from the government the true extent of the contamination in order to obtain an agreement at a lower cost than what was actually necessary for the remediation.²⁰³

Appeals, Second Circuit, 5 October 1998. Reproduced in 157 *Federal Reporter Third Series* (1998), at 53.

¹⁹⁸"US Court Sides with Chevron in Amazon Case," *Energy Compass*, 23 August 2002." For further discussion of these cases see Kimerling 2006.

¹⁹⁹"Chevron Says Victim of Unfair Trial in Ecuador," *Reuters*, 2 July 2007.

²⁰⁰In 2001 Chevron Corporation merged with Texaco.

²⁰¹"ChevronTexaco and Texaco Petroleum company File Arbitration Claim to Enforce Petroecuador's Obligations under Joint Operating Agreement," *ChevronTexaco News Release*, 15 June 2004, <http://www.texaco.com/sitelets/ecuador>.

²⁰²ROE I, at 352.

²⁰³"Ecuador Seeks Chevron Probe: U.S. Officials Asked to Look at Rain Forest Contamination Claim," *San Francisco Chronicle* 23 December 2006.; "Chevron Faces Fraud Charges in Ecuador Over Flawed Environmental Remediation, Amazon Watch Says," *PR Newswire*, 8 November 2006.

On 19 June 2007, the New York Southern District Court ruled that the JOA was not applicable to the Government of Ecuador or Petroecuador, because neither was a signatory to the agreement.²⁰⁴ The contract, as mentioned above, was signed between the Gulf Oil Company and Texaco. Chevron claimed that the terms of the JOA had been transferred to Petroecuador when it bought Gulf Oil's stake, but the Judge ruled that Ecuadorian law in the 1970s was too 'unsettled' to assume that it would support this claim.²⁰⁵

According to the company:

The Court did not rule on the fundamental issue related to Chevron's claim for arbitration - that Petroecuador is obligated to indemnify TexPet (and Chevron) for any claims against it. Rather, the Court simply ruled that, in its opinion, this was not an issue that should be addressed by arbitration in New York.²⁰⁶

Chevron subsequently filed a notice of appeal of the New York District Court ruling.

Outcome

The arbitration proceedings in the AAA are under an injunction, and meanwhile the liability case against ChevronTexaco in Ecuador continues. Despite having pushed for the case to be heard in Ecuador, rather than the US, Chevron has been very critical of the judicial process in the country and has indicated that it may pursue investment arbitration on the basis of denial of justice and lack of due process. According to Chevron's managing counsel for Latin America, Ricardo Viega, the company "will not hesitate to go to international tribunals to review what we believe in an unfair trial and lack of due process in this country."²⁰⁷ In

²⁰⁴ *Republic of Ecuador and Petroecuador, Plaintiffs, Counterclaim Defendants, v. ChevronTexaco Corporation and Texaco Petroleum Company, Defendants, Counterclaim Plaintiffs*, United States District Court, South District New York, 19 June 2007.

²⁰⁵ "New York Court Rules Against Chevron in Environmental Dispute with Ecuador," *Investment Treaty News*, 31 May 2006.

²⁰⁶ "Chevron Responds to Comments by Amazon Defense Front Regarding U.S. Court Decision," *ChevronTexaco News Release*, 22 June 2007, <http://www.texaco.com/sitelets/ecuador>.

²⁰⁷ "Chevron Says Victim of Unfair Trial in Ecuador," *Reuters*, 2 July 2007.

such a case, a question arises as to whether the company would have access to arbitration through the US-Ecuador BIT, signed in 1993 and in force as of 1997.²⁰⁸ According to the BIT, the Treaty applies only to “investments existing at the time of entry into force as well as to investments made or acquired thereafter.”²⁰⁹ As already mentioned, Texaco left Ecuador in 1992, and even the settlement agreement on remediation was signed before 1997.

Nevertheless, the company has been very vocal with its claims, and in October 2007, Chevron’s legal team submitted a petition to dismiss the case to the President of the Superior Court of Justice of Nueva Loja.²¹⁰ The petition outlines a long list of actions during the trial that when taken together, according to the company, constitute a denial of justice. An English translation of the petition states that:

International law imposes on Ecuador, at a very minimum, an obligation to maintain and make available to aliens such as Chevron a fair and effective system of justice. A failure of this universal obligation to provide a capable and impartial judiciary results in a denial of justice, an international violation by a State’s judiciary for which the State is held responsible. If this Court continues on its present, unjust path and ultimately issues a final judgment in the Plaintiffs’ favor, Chevron will take the necessary steps to seek redress against Ecuador under international law.²¹¹

It goes on to state that the lawsuit, “as it has transpired, constitutes a flagrant and grotesque violation of Ecuadorian law, a farce of the judicial system, as well as a violation of the most basic and fundamental principles of universal justice to which Chevron is entitled.”²¹²

A lawyer for the Plaintiffs in the case, Alejandro Ponce, highlights that “[i]t is ironic that Chevron, which argued in New York for over a decade that this trial

²⁰⁸Treaty between the United States of America and the Republic of Ecuador Concerning the Encouragement and Reciprocal Protection of Investment, 27 August 1993, Washington, D.C.

²⁰⁹*Ibid.*, at Art. XII.1.

²¹⁰“Chevron Calls for Dismissal of Ecuador Lawsuit,” *Chevron News Release*, 8 October 2007, <http://www.chevron.com>.

²¹¹English translation of the original Spanish Petition, at 46, <http://www.texaco.com/sitelets/ecuador>.

²¹²*Ibid.*, at 46-7.

should be held in Ecuador, is now trying to avoid responsibility by questioning the fairness of the trial here.”²¹³

6.2.3 Analysis

The section assesses the role that the threat of arbitration played in the outcome of each conflict. It also compares the factors that contributed to the efficacy of the threat of arbitration in each case.

The Threat of Arbitration

In these cases the threat of arbitration must be assessed by two different sets of actors: judges and government officials.

In the Newmont case, the Indonesian judge was faced with the prospect of the state being taken to arbitration if he did not dismiss the civil suit against the company. However, it cannot be stated definitively that the judge based his decision on the threat of arbitration. It is possible that the judge found Newmont’s legal argument (that arbitration was the proper forum) to be sound, even though NGOs and officials from the Environment Ministry were of the opinion that it was not. In the ChevronTexaco case there does not appear to be any evidence, as of yet, that threats from the company to sue Ecuador for denial of justice and lack of due process have impeded the progress of the class action case against the company. This may be because the judge views the threat as lacking any substantial basis in the absence of BIT.

As for the assessment of threats to arbitrate by government officials, it should be emphasized that the Indonesian government was not faced with a typical threat of arbitration in the Newmont case, as the company was not seeking damages. The government was given the option to pursue its liability case in arbitration, but chose instead to settle. In the ChevronTexaco case, government officials took the threat of arbitration very seriously. However, rather than settling with the company or submitting to arbitration, the government initiated court proceedings in

²¹³“Chevron Increasingly Desperate in \$6 Billion Environmental Lawsuit in Amazon Rainforest: Chevron Seeks to Avoid Judgment It Requested in 2002,” *Amazon Watch News Release*, 2 July 2007, <http://www.amazonwatch.org>.

the State of New York. The government was successful in blocking the arbitration in this instance, but it is important to recognize that its victory was based on technicalities; the status of the contract and the absence of an applicable BIT or regional agreement barred ChevronTexaco from arbitration. Had there been a contract signed by both parties, or had there been an IIA in place at the time of investment, the outcome of the conflict could have been quite different.

Factors that Contributed to the Efficacy of the Threat

In these cases, concerns about the cost of compensating investors were not significant. In this Indonesian case it was the government that was seeking compensation, thus at most it would have been concerned with the cost of arbitration and the potential that it would have to pay Newmont's legal fees if suffered a defeat. Similarly, the Ecuadorian government could not stop or interfere with the class action lawsuit against ChevronTexaco, and would have likely faced the a comparable compensation claim in a either a settlement or an arbitration (i.e. it would be based on the amount that ChevronTexaco was found liable for in the lawsuit). Hence, the potency of the threat was not enhanced by financial concerns.

In terms of reputational concerns, the story is less clear-cut than in the cases related to environmental policy. In the Buyat Bay case, it was the government that took the initiative to take Newmont to court, in both civil and criminal proceedings. This move, in itself, might appear to negate any interest by the government in achieving an investor-friendly reputation. In particular, many reports on the criminal proceedings suggested that investors were closely watching the case, and the chairman of the Indonesian Mining Association stated that a guilty verdict would have sent a negative message to all investors.²¹⁴ However, when one recognizes that it was not the Indonesian government as a whole, but rather the Ministry of Environment that took the case to court, then it becomes clear that domestic political factors explain the apparent incongruity. The Ministry of Environment is chiefly concerned with its own mandate, which does not concern the attraction of foreign investment, but this does not mean that other government departments and ministries do not prioritize this issue.

²¹⁴“Newmont Boss Could Face Three Years for Pollution,” *The Jakarta Post*, 11 November 2006; “Indonesian Court Acquits Newmont, Ness of Pollution,” *Bloomberg*, 24 April 2007.

As for the Government of Ecuador, it arguably had no control over the reputational effect of the class action lawsuit against ChevronTexaco, as it was brought to the local courts by individuals. Thus, regardless of whether the government was concerned with the implications of the lawsuit for its reputation with investors, there is very little that it could do to remedy the situation except to offer to pay the company compensation in the event of a ruling in favour of the Plaintiffs. However, in any case, at this point the government does not appear to be particularly interested in an investor-friendly image, but instead is aligning with other leftist governments in Latin America who have rebelled against neoliberal economic policies (see 7.4.3). Thus, the decision of the government to fight Chevron's move to arbitrate is unsurprising in this regard.

In addition to the reputational concerns of governments, one could also hypothesize that the judges in each case have concerns about their own reputations and about the reputation of the country's judicial system as a whole. To have a ruling criticized by a respected group of international arbitrators could be embarrassing and damaging for a judge's career. To have a proceeding deemed a denial of justice could harm the reputation of the entire court system of a country. Hence, it is possible that the judges in each case might have been influenced by such concerns.

Finally, the domestic politics in each case should be emphasized. The Ecuadorian government was unified in its opposition to arbitration proceedings, and the President even openly supported the Plaintiffs in the lawsuit against ChevronTexaco. This no doubt limited the efficacy of the threat to arbitrate. In contrast, the divisions in the Indonesian government likely contributed to the decision to settle with Newmont. The original case in the domestic courts was brought by the Ministry of Environment. The Ministry of Mines was not in favour of litigating against Newmont, but evidently it cannot stop the Ministry of Environment from launching a case in the local courts. However, the arbitration process is significantly different, and cannot be initiated by an individual ministry unless it has the support of the whole government.

Alternative Scenarios

As noted above, it is possible that the threat of arbitration was not a motivating factor for the Indonesian judge to dismiss the case against Newmont: he may have simply agreed with the legal argument. However, it is clear that the institution of investment protection was central in this case. While the Buyat Bay civil lawsuit may have eventually been either dismissed or amicably settled for any number of reasons, the case would not have been dismissed for the reason that the domestic courts were an incorrect forum had there not been a CoW which stipulated that all disputes should be settled in arbitration. Even if corruption was involved, the judge would not have been able to employ his particular reasoning for the dismissal in the absence of a CoW.

As for the Ecuadorian case, it appears that the outcome in this case is a result of the absence of investment protection. It is interesting to consider what might have happened if the JOA had been applicable, or the US-Ecuador BIT had been in force. In the case of the contract being valid, the dispute would have ended up in the AAA, an arbitral body with much less transparency than ICSID. Ecuador could have been held liable for any compensation awarded against Chevron. Had a BIT been in place, Chevron's threats to sue Ecuador for denial of justice would also have been more substantial and might have influenced the courts.

6.3 Implications for Environmental Governance

While the concerns over tribunal decisions made in the investor-state disputes discussed in the previous chapter are merited, given the weak bargaining position of many states, negotiated outcomes to conflicts may be as, or even more, undesirable from an environmental policy perspective. Furthermore, as threats of arbitration are very difficult to track and may never even be made known to the public, they represent, as MacArthur puts it, a "more insidious danger."²¹⁵

In some of the cases discussed in this chapter, governments did not bow to pressure to settle or arbitrate (e.g., Costa Rica in the Harken case) or they actively fought arbitration proceedings in the courts (e.g., Ecuador in the ChevronTexaco

²¹⁵MacArthur 2003, at 945.

case). However, the states in these cases were arguably successful because the investors were not actually protected by contracts or treaties, and that this suggests that similar cases could emerge under different circumstances with much more significant implications.

This section explores further the potential implications of threats to arbitrate for environmental governance, particularly in developing countries.

6.3.1 Maintenance of the Status Quo

Several of the cases illustrate that, in addition to fearing industrial flight as the traditional regulatory chill hypothesis assumes, governments maintain the status quo in environmental regulation out of fear of breaching commitments in contracts and treaties, and that these two fears are tightly intermingled. The main factors that contribute to regulatory chill appear to be the level of government concern about the country's reputation with investors, the potential cost of compensating investors, and prior negative experience in arbitration.

It is not suggested here that regulatory chill occurs in all cases. On the other end of the spectrum, governments arguably might use the existence of contractual commitments as an excuse for to the maintenance of the status quo in environmental policy. The idea of 'political cover', a concept borrowed from the literature on interstate disputes, may be useful in explaining the behaviour of government actors (see Section 3.3.2). This theory can be extended to suggest that a government (or part of a government) could use the specter of international arbitration as political cover for a controversial decision - an 'our hands are tied', 'we can't afford to be sued' argument. The existence of a stability promise in a state contract with binding arbitration clauses could be used quite effectively in this way, particularly if a previous government was responsible for the negotiation and signing of the contract.

Discerning when a government is being genuinely constrained by a contractual commitment (regulatory chill), and when it is instead using that this commitment as a convenient defence for a politically unpalatable position (political cover), is difficult in practice. For example, in the Ghanaian case it initially appeared that the government had experienced regulatory chill, until it subsequently began to offer new contracts in forest reserves. In either case, the end result re-

mains negative from the perspective of environmental policy development.

6.3.2 Domestic Political Divides

While the cases in the previous chapter indicated that investment arbitration can create tension between different levels of government (e.g., federal v. state or provincial), the cases in this chapter illustrate that the complex relations between departments and ministries within a level of government are also relevant. Each ministry, agency, or even department within a ministry, may have an agenda that is particular to its mandate. It is rare that the separate interests of various branches of government are coordinated with one another to guarantee the perfect compatibility of these agendas.²¹⁶ In the context of investment protection, contracts and IIAs are not likely to be negotiated by the ministries/agencies that make the social and environmental policies that are affected by them. While environmental ministries may seek to be progressive in policy development and may seek to redress environmental harm through court action, it may be in the interests of other ministries (mining, economic, foreign, etc.) to ensure the maintenance of the status quo in order to secure a friendly investment climate.

Ministries involved in investment and economic development are likely to hold a stronger position in the government hierarchy than environmental ones, and the existence of a strong institution for investment protection may serve to reinforce or even exacerbate these power structures. With their position ‘backed-up’ by a strong international enforcement mechanism, these interest groups have an advantage over environmental ministries, which can only point to the existence of vague and unenforceable commitments in MEAs. Furthermore, foreign investors can strategically exploit these divides by targeting their lobbying efforts at the specific ministries, departments, and agencies that are most likely to support them.²¹⁷

Internal political wrangling may also harm the state’s defence if a case proceeds to arbitration because counsel must represent a multitude of potentially conflicting policy interests, and this can lead to a lack of a cohesive strategy.²¹⁸

²¹⁶Leon and Terry 2006, at 71.

²¹⁷*Ibid.*

²¹⁸Denyse MacKenzie, Principal Counsel of the Trade Law Bureau at the Canadian Department of

6.3.3 Environmental Liability

Several of the cases in this chapter, particularly the final two, illustrate how international arbitration can affect the domestic judicial process.

In the Buyat Bay case, the existence of a contract with an arbitration clause determined the outcome of the civil court proceedings, despite the fact that the case related to breach of the Indonesia's national environmental law, rather than breach of contract. As mentioned previously, a CoW specifies the environmental obligations of the company in general terms; basically the company must comply with laws and regulations. Thus, if an arbitration panel were expected to rule on whether Newmont should be found liable for environmental damage in Buyat Bay, they would have to look to, and interpret, Indonesian environmental law. This is a significant outcome, regardless of what one makes of the merits of the Ministry of Environment's case against Newmont. Aside from the fact that arbitrators are generally experts in investment and commercial law, rather than environmental law (let alone the specific environmental law of Indonesia) one also has to consider the additional consequences of this shift from domestic courts and to international arbitration which entails significant costs for states and is customarily non-transparent and closed to non-disputing parties.

The Ecuador case also has several important implications. The initial conflict over who (ChevronTexaco or Petroecuador) was liable for the pollution in the Ecuadorian Amazon, was based on a contract and is perhaps less broadly applicable to other situations. However, the later claims of 'lack of due process' and 'denial of justice' could have significant implications for environmental liability cases in many developing countries. While there have been extensive discussions in the literature about foreign direct liability and the problem of *forum non conveniens*, there does not appear to have been significant attention paid to the threat of BITs and other IIAs to the pursuit of environmental liability claims in the host state.

While courts in developing countries are often claimed to be biased and unreliable, it is worth noting that developed country courts have not escaped the scrutiny of arbitral tribunals. In this respect, two NAFTA cases that were not discussed in the previous chapter (as they did not directly relate to environmental regulation)

Foreign Affairs and International Trade, cited in Dodge 2001b, at 200.

are worth mentioning. In the *Mondev* case, a Canadian real-estate development corporation submitted a claim based in part on a decision by the Supreme Judicial Court of Massachusetts.²¹⁹ Although the *Mondev* Tribunal dismissed the investor's claims on the merits, Amirfar and Dreyer suggest that "its recognition that liability may result from a breakdown of judicial function is itself notable."²²⁰ In the *Loewen* case, an Canadian investor brought a suit against the US based on the conduct and verdict of a Mississippi State Court.²²¹ The *Loewen* Tribunal determined that it did not have jurisdiction over the dispute because the investor had not exhausted local remedies. While under the NAFTA there is no general requirement to exhaust local remedies, it was determined by the Tribunal that in cases where the measure concerned is a ruling of a lower court, the higher courts must have an opportunity to review the case before it can be elevated to international arbitration. Despite the fact that the *Loewen* Tribunal did not make a decision on the merits of the case, they did express their opinion that, had domestic remedies been exhausted, they would have had competence to review the Mississippi court's actions and likely would have found them in breach of the NAFTA. Hill suggests that "the threat to domestic sovereignty presented by *Loewen* is difficult to overstate."²²²

Other arbitral tribunals outside of the NAFTA have also found states responsible for the losses suffered by foreign investors because they found domestic court decisions to amount to a denial of justice.²²³ Although the standard of denial of justice should be difficult to meet, it can be hypothesized that the threat of arbitration may nevertheless influence a state or indeed a court, leading to *judicial chill*.

²¹⁹ *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2, Award, 11 October 2002, <http://www.state.gov>. Reproduced in 42 *ILM* (2003), at 85.

²²⁰ Amirfar and Dreyer 2007, at 44.

²²¹ *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3, Award, 26 June 2003, <http://www.state.gov>. Reproduced in 42 *ILM* (2003), at 811.

²²² Hill 2006, at 168.

²²³ Cheng 2005, at 508-9.

6.4 Summary

This chapter examined cases in which the threat of arbitration played a role in the eventual resolution of investor-state conflicts. The first section explored conflicts related to environmental regulation or the decisions of environmental agencies in Indonesia, Ghana, and Costa Rica. The second section examined conflicts related to environmental liability cases brought in the courts of Indonesia and Ecuador. The cases illustrate that arbitration presents a viable threat to governments not only because it is a costly and uncertain process but also because it raises concerns about a country's reputation with potential investors. However, the cases also demonstrate that government responses to threats to arbitrate are varied. Furthermore, the cases also show that it is crucial to examine the state not as a unified actor, but as composed of multiple competing agents with often conflicting agendas.

The cases in this chapter indicate that regulatory chill may result when governments are threatened with arbitration. However, it has also been argued that an opposite trend, with equally negative implications for environmental governance, may also occur; governments, or certain government agencies, may use the existence of commitments to investment protection as political cover, in order to dispel political opposition to their decisions.

The cases in this chapter suggest that state contracts, which have been largely neglected in studies of investment and the environment, can have significant implications for environmental governance. The cases concerning environmental liability also open up a new avenue of research. Much of the discussion in the literature focuses on foreign direct liability and the problem of *forum non conveniens*. The cases presented here indicate that investment protection may present a further obstacle to liability claims in the domestic courts of host states.

New Developments

The period over which this study was conducted was one of rapid development in the field of investment law and arbitral practice. The substantial increase in the use of investment arbitration has led to greater scrutiny of the regulative and procedural norms and rules of investment protection, and in some cases, to a re-evaluation of the purpose and function of these norms and rules. States, arbitral supervisory bodies, arbitrators, and NGOs have all played a role in bringing about change. This chapter describes the new developments in the field and assesses the extent to which they may resolve the issues related to environmental governance and to developing countries that have been raised in previous chapters. Several proposals for more substantial reform, such as the creation of an appellate body or a multilateral investment agreement for sustainable development, are also reviewed.

7.1 Transparency and Third Party Participation

As mentioned in Section 4.3.2, the system of investment arbitration has been criticized for adopting procedures that are well-established in the realm of commercial arbitration, but that are thought to be inappropriate when applied to disputes involving states and, thereby, issues of public concern. Since 2001, there have been

a number of changes to the investment arbitration process (in certain contexts) aimed at remedying the system's failings in this regard. The two developments of particular note are increased transparency and acceptance of third party participation in disputes.¹

Transparency relates not only to the publication of awards but also to access to pre-award submissions from the parties and to decisions made by the tribunal over the course of the proceedings. Furthermore, it also relates to public admittance to the tribunal hearings. As for third party participation, in international tribunals this most commonly occurs through the submission of *amicus curiae* ('friend of the court') briefs. *Amicus curiae* submissions generally contain "supplementary information on the case, particularly the occurrence of events or technicalities relating to the subject at hand."² *Amici* are different from expert witnesses as they are not remunerated for their services and they are not in a contractual relationship with the parties to the dispute.³ While historically there has been no role for *amici* in investor-state disputes, in recent years a trend of such participation has been emerging. The precedent⁴ for such participation was set within the context of the NAFTA, but the idea has also spread to BITs negotiated by Canada and the US, and was incorporated into the new ICSID Rules in 2006.

Transparency and third party participation are intimately linked. Without public knowledge of the existence of disputes, *amici* will be precluded from making submissions. Furthermore, it can be argued that without access to relevant documents and to the proceedings, third parties will be incapable of formulating effective and worthwhile submissions.

7.1.1 Methanex and the NAFTA FTC Guidelines

The substantive aspects of the *Methanex* case have already been discussed in Section 5.2.5; therefore this section will only discuss procedural decisions made by the Tribunal.

¹An earlier version of this section was published in Tienhaara 2007.

²Bennaim-Selvi 2005, at 786.

³Mistelis 2005, at 231.

⁴The term 'precedent' is used here very loosely, as there is no formal *stare decisis* in investment arbitration. See Section 4.2.2.

In 2000, two requests were made by NGOs for permission to file *amicus curiae* briefs, to make oral submissions and have observer status at oral hearings in *Methanex*.⁵ The US and Methanex both filed submissions responding to the Petitioners' requests, as did the non-disputing parties of the NAFTA (Canada and Mexico). Both Methanex and Mexico opposed the acceptance of *amicus curiae* briefs, while Canada and the US showed support. The US also indicated its willingness to open the proceedings and to disclose documents to the public.

In a groundbreaking decision, the Tribunal concluded that it had the power to accept *amicus curiae* submissions, but no power to authorize access to materials or to allow the Petitioners to attend hearings.⁶ The Tribunal found that UNCITRAL Rule 15.1, which states that "the arbitral tribunal may conduct the arbitration in such manner as it considers appropriate, provided that the parties are treated with equality and that at any stage of the proceedings each party is given a full opportunity of presenting his case," gave it the discretion to accept *amicus curiae* submissions. However, the Tribunal made it clear that UNCITRAL Rule 25.4, which requires hearings to be private unless otherwise agreed by the parties, limits the flexibility of Rule 15.1. Furthermore, while indicating that it was minded to accept *amicus curiae* submissions in this case, the Tribunal chose to delay its final decision until a later stage in the dispute.

It is clear that one of the reasons the Tribunal was amenable to accepting briefs was that it believed that this would improve the public image of investment arbitration:

[the] arbitral process could benefit from being perceived as more open or transparent; or conversely be harmed if seen as unduly secretive. In this regard, the Tribunal's willingness to receive *amicus* submissions might support the process in general and this arbitration in particular; whereas a blanket refusal could do positive harm.⁷

On 7 October 2003, the NAFTA FTC, made up of representatives of the three

⁵Petition to the Arbitral Tribunal of the IISD, 25 August 2000, <http://www.iisd.org>; Amended Petition of Communities for a Better Environment, the Bluewater Network of the Earth Island Institute, and CIEL to Appear Jointly as *Amici Curiae*, 13 October 2000, <http://www.earthjustice.org>.

⁶*Methanex Corp. v. United States of America*, Decision of the Tribunal on Petitions from Third Parties to Intervene as '*Amici Curiae*', 15 January 2001, at para. 47, <http://www.investmentclaims.com>.

⁷*Ibid.*, at para. 49.

NAFTA countries, issued a statement on third party participation in Chapter 11 disputes.⁸ The statement stipulated that any non-disputing party that is a person of a Party (a NAFTA state), or that has a significant presence in the territory of a Party, could apply for leave to file a submission. The statement also outlined guidelines for the acceptance of such submissions. According to these guidelines, in the application for *amicus* status the person or organization should disclose any affiliations or financial ties to either party in the dispute, indicate the nature of their interest in the dispute, and provide reasoning as to why the tribunal should accept the submission. Furthermore, the guidelines suggest that the tribunal, when making its decision, should consider the extent to which:

- a. the non-disputing party submission would assist the Tribunal in the determination of a factual or legal issue related to the arbitration by bringing a perspective, particular knowledge or insight that is different from that of the disputing parties;
- b. the non-disputing party submission would address matters within the scope of the dispute;
- c. the non-disputing party has a significant interest in the arbitration; and
- d. there is a public interest in the subject-matter of the arbitration.

It was also noted in the statement that in arbitrations to which they are a party, Canada and the US would consent to open the hearings to the public (the consent of the investor would also be required). Mexico announced its support for public hearings in investor-state disputes the following year.⁹

Shortly after the 2003 NAFTA FTC statement was issued, Methanex wrote to the Tribunal, on behalf of both disputing parties, to suggest that the FTC guidelines for the acceptance of *amicus curiae* submissions be adopted. The Tribunal did so in January of the following year and issued a press release outlining the procedures to be followed by potential *amici*. The original Petitioners submitted

⁸“Celebrating NAFTA at Ten,” *NAFTA Commission Meeting Joint Statement*, 7 October 2003, Montreal, <http://www.ustr.gov>.

⁹“A Decade of Achievement,” *NAFTA Free Trade Commission Joint Statement*, 16 July 2004, San Antonio, Texas, <http://www.ustr.gov>.

their briefs in March 2004.¹⁰ It is notable that the Tribunal made reference to the *amicus curiae* brief of the International Institute for Sustainable Development (IISD) in its Final Award, describing it as “carefully reasoned.”¹¹ The proceedings in *Methanex* were also eventually opened to the public, but only with the consent of both parties.

In the same period as *Methanex* was transpiring, another (NAFTA/UNCITRAL) tribunal in the case *United Parcel Service (UPS) v. Canada* also found that it had the power to accept *amicus* briefs, and more recently the (NAFTA/UNCITRAL) tribunal in *Glamis Gold v. United States* has also done so (see Sections 5.3.1 and 7.1.5).¹²

7.1.2 Provisions in Recent BITs

In 2003 and 2004 respectively, the Governments of Canada and the US released new versions of their model BITs.¹³ The Canadian government had been a strong proponent of permitting third party participation in NAFTA Chapter 11 disputes, and the government website notes that “[one] of the most significant improvements” made in the new Model FIPA is the “institutionalisation” of *amicus curiae* submissions.¹⁴ The Model follows the NAFTA FTC guidelines on *amicus curiae* submissions quite closely.¹⁵ The Model also stipulates that hearings will be open to the public and that all documents and awards will be freely available (with

¹⁰Submission Of Non-Disputing Parties Bluewater Network, Communities For A Better Environment and CIEL, 9 March 2004, <http://www.ciel.org>; *Amicus Curiae* Submission by the IISD, 9 March 2004, <http://www.iisd.org/>.

¹¹*Methanex* Final Award, at para. IV.B.27.

¹²*United Parcel Service (UPS) v. Canada*, Decision of the Tribunal on Petitions for Intervention and Participation as Amici Curiae, 17 October 2001, <http://www.naftaclaims.com>.

¹³Agreement between Canada and for the Promotion and Protection of Investments (Canadian Model FIPA), 2003, <http://www.international.gc.ca>; Treaty between the Government of the United States of America and the Government of [Country] Concerning the Encouragement and Reciprocal Protection of Investment (US Model BIT), 2004, <http://www.state.gov>.

¹⁴“Canada’s Foreign Investment Protection and Promotion Agreements (FIPAs) Negotiating Programme,” *Foreign Affairs and International Trade Canada website*, <http://www.international.gc.ca>, accessed 4 January 2008.

¹⁵Canadian Model FIPA, at Art. 39.

certain limits to protect confidential information).¹⁶

The US Model BIT has a less detailed provision on participation, which states that “[t]he tribunal shall have the authority to accept and consider *amicus curiae* submissions from a person or entity that is not a disputing party.”¹⁷ The model also provides public access to all documents and awards and open proceedings.¹⁸ These provisions have already been incorporated into the US-Chile FTA,¹⁹ the CAFTA-DR,²⁰ the US-Morocco FTA,²¹ the US-Singapore FTA,²² the US-Uruguay BIT,²³ the US-Columbia Trade Promotion Agreement,²⁴ and the US-Peru Trade Promotion Agreement.²⁵

7.1.3 ICSID’S Rules, Old and New

In 2006, ICSID updated its Rules of Procedure for Arbitration Proceedings. Changes to two rules in particular are relevant to the issues of third party participation and transparency. The most significant change was to Rule 37 (Visits and Inquiries), where a second paragraph was added stipulating that, after consulting both parties, a tribunal could allow a non-disputing party to submit a written brief if it considered that:

- a. the non-disputing party submission would assist the Tribunal in the determination of a factual or legal issue related to the proceeding by bringing a perspective, particular knowledge or insight that is different from that of the disputing parties;
- b. the non-disputing party submission would address a matter within the scope of the dispute;

¹⁶*Ibid.*, at Art. 38.

¹⁷US model BIT, at Art. 28.3.

¹⁸*Ibid.*, at Art. 29.

¹⁹US-Chile FTA, 6 June 2003, Miami, at Art. 10.19 and 10.20.

²⁰CAFTA-DR, at Art. 10.20 and 10.21.

²¹US-Morocco FTA, 15 June 2004, Washington, at Art. 10.19 and 10.20.

²²US-Singapore FTA, 6 May, 2003, Washington, at Art. 15.19 and 15.20.

²³US-Uruguay BIT, 4 November 2005, Mar del Plata, at Art. 28 and 29.

²⁴US-Columbia Trade Promotion Agreement, 22 November 2006, Washington, at Art. 10.20 and 10.21.

²⁵US-Peru Trade Promotion Agreement, 12 April 2006, Washington, at Art. 10.20 and 10.21.

- c. the non-disputing party has a significant interest in the proceeding.

The Rule also states that the tribunal “shall ensure that the non-disputing party submission does not disrupt the proceeding or unduly burden or unfairly prejudice either party, and that both parties are given an opportunity to present their observations on the non-disputing party submission.”

Rule 32 (Oral Procedure), which determines who may attend hearings, was also slightly modified (see Table 7.1). However, the modification from the wording of the former Rule - “The Tribunal shall decide, with the consent of the parties” - to the new wording - “Unless either party objects” - is, in practice, very limited. The bottom line is that not all proceedings will be opened to the public under the new Rules.

Prior to the change in the ICSID Rules there were several cases that dealt with the issue of third party participation, and since the adoption of the new Rules there has been a further case in which NGOs have petitioned for *amicus curiae* status.

Decisions Under the Old Rules

Several cases involving water privatizations in South America have dealt with the issue of *amicus curiae* submissions under the old ICSID Rules. The first was *Aguas del Tunari, S.A. v. Republic of Bolivia*. This case dealt with the highly publicized and highly controversial case of the privatization of water services in the City of Cochabamba in Bolivia. After a 40-year concession was awarded to the company Aguas del Tunari (a subsidiary of Bechtel Corporation), water prices skyrocketed, leading to widespread public protest. In 2000, the company abandoned the project and in 2001 filed a request for arbitration with ICSID.²⁶

In 2002, several organizations and individuals petitioned for *amicus curiae* status, requesting permission to make submissions as well as the right to attend all hearings, to make oral presentations, to have immediate access to all submissions made to the Tribunal, and to respond to arguments made by either party.²⁷ In addition, the Petitioners requested that the proceedings be opened to the public,

²⁶*Aguas del Tunari, S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Respondent’s Objections to Jurisdiction, 21 October 2005, <http://icsid.worldbank.org>.

²⁷Petition of La Coordinadora Para la Defensa del Agua y Vida, La Federacion Departamental Cochabamba de Organizaciones Regantes, Sempa Sur, Friends of the Earth Netherlands, Oscar

Table 7.1: A Comparison of the Old and New ICSID Rules

	<i>Pre-April 2006 (Old Rules)</i>	<i>April 2006 (New Rules)</i>
<i>Rule 32 (The Oral Procedure)</i>	<p>(1) The oral procedure shall consist of the hearing by the Tribunal of the parties, their agents, counsel and advocates, and of witnesses and experts.</p> <p>(2) The Tribunal shall decide, with the consent of the parties, which other persons besides the parties, their agents, counsel and advocates, witnesses and experts during their testimony, and officers of the Tribunal may attend the hearings.</p> <p>(3) The members of the Tribunal may, during the hearings, put questions to the parties, their agents, counsel and advocates, and ask them for explanations.</p>	<p>(1) The oral procedure shall consist of the hearing by the Tribunal of the parties, their agents, counsel and advocates, and of witnesses and experts.</p> <p>(2) Unless either party objects, the Tribunal, after consultation with the Secretary-General, may allow other persons, besides the parties, their agents, counsel and advocates, witnesses and experts during their testimony, and officers of the Tribunal, to attend or observe all or part of the hearings, subject to appropriate logistical arrangements. The Tribunal shall for such cases establish procedures for the protection of proprietary or privileged information.</p> <p>(3) The members of the Tribunal may, during the hearings, put questions to the parties, their agents, counsel and advocates, and ask them for explanations.</p>
<i>Rule 37 (Visits and Inquiries)</i>	<p>If the Tribunal considers it necessary to visit any place connected with the dispute or to conduct an inquiry there, it shall make an order to this effect. The order shall define the scope of the visit or the subject of the inquiry, the time limit, the procedure to be followed and other particulars. The parties may participate in any visit or inquiry.</p>	<p>(1) If the Tribunal considers it necessary to visit any place connected with the dispute or to conduct an inquiry there, it shall make an order to this effect. The order shall define the scope of the visit or the subject of the inquiry, the time limit, the procedure to be followed and other particulars. The parties may participate in any visit or inquiry.</p> <p>(2) After consulting both parties, the Tribunal may allow a person or entity that is not a party to the dispute (in this Rule called the “non-disputing party”) to file a written submission with the Tribunal regarding a matter within the scope of the dispute. In determining whether to allow such a filing, the Tribunal shall consider, among other things, the extent to which:</p> <p>(a) the non-disputing party submission would assist the Tribunal in the determination of a factual or legal issue related to the proceeding by bringing a perspective, particular knowledge or insight that is different from that of the disputing parties;</p> <p>(b) the non-disputing party submission would address a matter within the scope of the dispute;</p> <p>(c) the non-disputing party has a significant interest in the proceeding.</p> <p>The Tribunal shall ensure that the non-disputing party submission does not disrupt the proceeding or unduly burden or unfairly prejudice either party, and that both parties are given an opportunity to present their observations on the non-disputing party submission.</p>

and that there be public disclosure of the submissions to the Tribunal. Finally, they requested that the Tribunal visit Cochabamba and hold public hearings concerning the facts underlying the claim.

The arbitrators unanimously decided that it was beyond their authority to grant the request.²⁸ Absent agreement of the parties, the Tribunal reasoned that it could not open the proceedings or provide access to documents. Furthermore, the Tribunal stated that it did not see the need to request submissions from third parties at that particular point in the case. The dispute was settled and the arbitration proceedings were discontinued at the mutual request of the parties on 28 March 2006.

In two cases currently pending against Argentina, the openness of ICSID Tribunals to *amicus curiae* briefs has also been tested. The cases, which relate to sewage and water distribution services, concern the government's freeze of public utility rates following the abandonment in 2001 of the system that pegged Argentina's currency to the dollar. In 2005, five NGOs filed a petition in the case of *Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v. The Argentine Republic* (hereinafter '*Suez/Vivendi*').²⁹ In June of the same year, in a second case - *Suez, Sociedad General de Aguas de Barcelona S.A. and Inter-Aguas Servicios Integrales del Agua S.A. v. The Argentine Republic* (hereinafter '*Suez/InterAguas*') - one NGO and three individuals filed a similar petition.³⁰ In both cases, the Tribunal was made up of the same members, and the orders in response to the petitions are substantively similar.

In both cases, the Tribunal determined that the Petitioners' request was composed of three parts: (i) permission to submit an *amicus curiae* brief; (ii) access to

Olivera, Omar Fernandez, Father Luis Sanchez, and Congressman Jorge Alvarado to the Arbitral Tribunal, 29 August 2002, <http://www.investmentclaims.com>.

²⁸ See the letter from the President of the Tribunal responding to the petition, 29 January 2003, <http://www.investmentclaims.com>.

²⁹ Petition for Transparency and Participation as Amicus Curiae of Centro de Estudios Legales y Sociales, Asociacin Civil por la Igualdad y la Justicia, Consumidores Libres Cooperativa Ltda. de Provisin de Servicios de Accin Comunitaria, Unin de Usuarios y Consumidores, and CIEL, 27 January 2005, unofficial translation from Spanish original, <http://www.cels.org.ar/english/index.html>.

³⁰ Peticin de Participacin como Amicus Curiae (Petition for Participation as Amicus Curiae) of Fundacin para el Desarrollo Sustentable, Professor Ricardo Ignacio Beltramino, Dr. Ana Mara Herren, and Dr. Omar Daro Heffes, June 21, 2005.

documents; and (iii) admittance to hearings.³¹ In both cases, the claimants asked the Tribunal to reject the petition while Argentina made no objection.

The Tribunal determined first that it was not able to open the hearings to third parties or to the public because of the requirement under ICSID Rule 32.2 for the consent of both parties.³² In both the *Methanex* and the *UPS* cases there was explicit consent to open the hearings, but in *Suez/Vivendi* and *Suez/InterAguas* it was lacking. Next, the Tribunal moved on to the issue of *amicus curiae* and determined that it did have the authority to accept briefs. Interestingly, in its explanation of this decision, the Tribunal noted that:

The acceptance of *amicus* submissions would have the additional desirable consequence of increasing the transparency of investor-state arbitration. *Public acceptance of the legitimacy of international arbitral processes, particularly when they involve states and matters of public interest, is strengthened by increased openness and increased knowledge as to how these processes function.*³³

In *Suez/Vivendi*, the Tribunal set out conditions by which the NGOs could apply for leave to make submissions, and in *Suez/InterAguas*, the Tribunal determined that the Petitioners had not met those same conditions, but could provide the Tribunal with further information in order to do so. In both cases, the decision as to whether to provide the Petitioners with access to documents was deferred until leave was granted to file *amicus curiae* briefs.

In December 2006, the Petitioners in the *Suez/Vivendi* case filed with the Tribunal a second petition, again requesting the opportunity to submit a written *amicus* submission and access to documents.³⁴ The Claimant asked the Tribunal to reject the petition, while Argentina made no objection.

³¹ *Suez, Sociedad General de Aguas de Barcelona S.A. and InterAguas Servicios Integrales del Agua S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/17, Order in Response to a Petition for Participation as Amicus Curiae (*Suez/InterAguas* Order), 17 March 2006; *Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/19, Order in Response to a Petition for Transparency and Participation as Amicus Curiae (*Suez/Vivendi* Order), 19 May 2005, <http://icsid.worldbank.org>.

³² See *ibid.*, para. 6-7 in both Orders.

³³ *Suez/InterAguas* Order, at para. 21, and *Suez/Vivendi* Order, at para. 22, emphasis added.

³⁴ Petition for Permission to Make an Amicus Curiae Submission of Centro de Estudios Legales y Sociales, Asociacin Civil por la Igualdad y la Justicia, Consumidores Libres Cooperativa Ltda. de Pro-

In February 2007, the Tribunal made its Order in response to the petition.³⁵ Following the guidelines that it had laid out in its initial Order in 2005, the Tribunal first assessed the suitability of the Petitioners to act as *amici*, based on their expertise, experience, and independence. It found that the NGOs had provided sufficient information to prove that they met these criteria. The Tribunal also found that there was a sufficient public interest in the case to justify third party participation. Finally, it found that the submission would not unduly impede the proceedings, although it did restrict the Petitioners to a 30-page brief. Turning next to the issue of access to documents, the Tribunal noted that even the new ICSID Rules (which did not apply to the dispute) provided no guidance on this issue. The Tribunal noted that:

As a general proposition, an *amicus curiae* must have sufficient information on the subject matter of the dispute to provide ‘perspectives, expertise and arguments’ which are pertinent and thus likely to be of assistance to the Tribunal. Otherwise the entire exercise serves no purpose.³⁶

However, the Tribunal went on to suggest that in this particular case, the Petitioners appeared to have access to sufficient information that was available in the public domain, and were therefore capable of making a useful brief without further access to arbitral documents. The Tribunal emphasized in this respect that the proper role of an *amicus curiae* “is not to challenge arguments or evidence put forward by the Parties” but to “provide their perspective, expertise, and arguments to help the court.”³⁷ The Petitioners made their submission in April 2007.³⁸

visin de Servicios de Accin Comunitaria, Unin de Usuarios y Consumidores, and CIEL, 1 December 2006, unofficial translation from Spanish original <http://www.cels.org.ar/english/index.html>.

³⁵ *Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/19, Order in Response to a Petition by Five Non-Governmental Organizations for Permission to Make an Amicus Curiae Submission, 12 February 2007, <http://icsid.worldbank.org>.

³⁶ *Ibid.*, at para. 24.

³⁷ *Ibid.*, at para. 25.

³⁸ Amicus Curiae Submission of Centro de Estudios Legales y Sociales, Asociación Civil por la Igualdad y la Justicia, Consumidores Libres Cooperativa Ltda. de Provisión de Servicios de Acción Comunitaria, Unión de Usuarios y Consumidores, and CIEL, 4 April 2007, <http://www.ciel.org>.

Testing the Water: Biwater and the Application of the New Rules

The *Biwater Gauff Ltd. v. United Republic of Tanzania* case is also worth reviewing, as it displays some of the limitations of the changes to ICSID's Rules, as well as the tension between transparency and confidentiality in proceedings.

In 2005, the Government of Tanzania canceled a contract of the private utility City Water, owned by British company Biwater. The contract was to supply water to the country's commercial capital, Dar es Salaam. The Government claimed that the reason for the cancellation was that the residents have had to cope with erratic supplies and water shortages.³⁹ In August of 2005, the company filed a request for arbitration based on a UK-Tanzania BIT and under ICSID Rules. By the time that the case had begun, the new ICSID Rules had come into effect and the Tribunal determined that they would govern the proceedings.

In July 2006, Biwater wrote a letter to the Tribunal claiming that the Government of Tanzania had unilaterally disclosed certain documents to an 'unrelated' third party.⁴⁰ Subsequently a procedural order and the minutes of the first session were published on the Internet. According to Biwater, the dispute was attracting public interest which had led to, for example, a campaign by the World Development Movement (an NGO based in London) to discontinue the proceedings. In a second letter, the company filed a request to the Tribunal for provisional measures on confidentiality.⁴¹ The request, which according to the company was based on the need to preserve the procedural integrity of the proceedings and to avoid aggravation or exacerbation of the dispute, called for the following:

- Discussion on a case-by-case basis of the publication of all Decisions other than the Award (if mutual agreement cannot be reached then Tribunal should make the decision);
- No disclosure of the pleadings to third parties;
- No disclosure of any documents produced in the first and second rounds of disclosure to third parties; and

³⁹“Tanzania Ditches Private Water Supplier,” *BBC News*, 18 May 2005.

⁴⁰*Biwater Gauff Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Procedural Order No. 3 (*Biwater* Procedural Order No. 3), 29 September 2006, <http://icsid.worldbank.org>.

⁴¹The letter, dated 17 July 2006, is referred to in *ibid*.

- No disclosure of any correspondence between the parties and/or the Tribunal in respect of the arbitral proceedings to third parties.

The Tribunal noted that Biwater considered these measures to be necessary as they concerned the company's "ability to rely on the private nature of the oral hearings, and its ability to present its case and accompanying evidence without the threat of increased harassment and interference from third parties."⁴²

In its Decision on Provisional Measures, the Tribunal suggested that what was required was "a careful balancing between two competing interests: the need for transparency and the need to protect the procedural integrity of the arbitration."⁴³ It commented that, "[w]ithout doubt, there is now a marked tendency towards transparency in treaty arbitration', which is reflected in the changes to ICSID's Rules."⁴⁴ The Tribunal reasoned that the provisions that continue to limit the publication of documents apply to the actions of the ICSID Secretariat, rather than to the parties themselves. However, the Tribunal also agreed with Biwater that:

... the prosecution of a dispute in the media or in other public fora, or the uneven reporting and disclosure of documents or other parts of the record in parallel with a pending arbitration, may aggravate or exacerbate the dispute and may impact the integrity of the procedure.⁴⁵

Furthermore, the Tribunal stated that placing restrictions on disclosure for the duration of the dispute is not necessarily inconsistent with the objective of transparency, as these restrictions can be removed upon the conclusion of the dispute.⁴⁶

The Tribunal determined that decisions on the publication of certain documents during the proceedings (decisions, orders, or directions) would be made on a case-by-case basis. Minutes or records of hearings would not be disclosed unless agreed by both parties or directed by the Tribunal and, furthermore, any documents produced by one party would not be disclosed by the opposing party. Pleadings, written memorials, witness statements and expert reports (which could

⁴² *Biwater* Procedural Order No. 3, at para. 38.

⁴³ *Ibid.*, at para. 112.

⁴⁴ *Ibid.*, at para. 114.

⁴⁵ *Ibid.*, at para. 136.

⁴⁶ *Ibid.*, at para. 140.

all contain details of the contents of other non-disclosed documents) would also be kept confidential pending the conclusion of the proceedings. Finally, correspondence between the parties and/or the Tribunal would not be disclosed as these documents “will usually concern the very conduct of the process itself, rather than issues of substance, and as such do not warrant wider distribution.”⁴⁷ The Tribunal emphasized that parties were permitted to “engage in general discussion about the case in public” as long as this was “restricted to what is necessary” and not used to “antagonise” or “unduly pressure” the other party or exacerbate the dispute, or make the resolution of the dispute more difficult.

In November 2006, five NGOs (three Tanzanian and two international) collectively petitioned for *amicus curiae* status in this case.⁴⁸ In doing so, they referred to the decisions in the *Suez/Vivendi* and *Suez/InterAguas* cases on the criteria for accepting such petitions, and also to the new ICSID Rules. They argued that the arbitration “raises a number of issues of vital concern to the local community in Tanzania, and a wide range of potential issues of concern to developing countries” and “also raises issues from a broader sustainable development perspective and is potentially of relevance for the entire international community.”⁴⁹

Interestingly, the Petitioners appear to have anticipated some of the possible objections to their participation in the dispute, pointing out that by acting together they had reduced the burden of additional *amicus curiae* submissions on the proceedings. The Petitioners also argued that without greater transparency, it would not be possible for them to meaningfully participate in the dispute, nor would it be possible for the Tribunal to even determine whether they passed the *amicus curiae* test provided by the ICSID Rules:

it is not possible for the Petitioners to fulfill all the conditions necessary to allow the Tribunal to fully apply this test. The reason for this impossibility is the impact of the confidentiality order contained in Procedural Order No. 3 of the Tribunal. By precluding the release to the public of the documents that detail the facts and legal issues in dispute, the Petitioners cannot describe the

⁴⁷*Ibid.*, at para. 161.

⁴⁸Petition for *Amicus Curiae* Status of the Lawyers’ Environmental Action Team, the Legal and Human Rights Centre, the Tanzania Gender Networking Programme, CIEL, and IISD, 27 November 2006, at 7, http://www.ciel.org/Publications/Tanzania_Amicus_1Dec06.pdf.

⁴⁹*Ibid.*

scope of their intended legal submissions, and hence the extent to which the tests set out in Rule 37.2 are fully met.⁵⁰

The Petitioners, therefore, suggested that the Tribunal could either accept the petition and provide them with the legal documents needed to make a submission, or provide them with the legal documents in order that they might be able to prove that they meet the requirements of the *amicus curiae* test.

In response, Biwater argued that the Petitioners had mistakenly assumed that the arbitration should concern them simply because the dispute related to water.⁵¹ Biwater disagreed that environmental issues and issues of sustainable development were relevant to the case.

The Tribunal's decision on *amicus curiae* was issued in February 2007.⁵² In line with previous decisions, submissions were allowed but access to documents and hearings was not permitted. The Tribunal reasoned that the Petitioners had "a sufficient interest" in the proceeding, and that their submission had the potential to assist the Tribunal in the proceedings, by providing a perspective or knowledge that was different from that of the disputing parties. The Tribunal also noted "that allowing for the making of such submission by these entities in these proceedings is an important element in the overall discharge of the Arbitral Tribunal's mandate, and in securing wider confidence in the arbitral process itself."⁵³ In terms of access to documents, the Tribunal suggested that the dispute had been very public and widely reported, and that the "broad policy issues" that the Petitioners would address in their brief did not require access to documents from the arbitration.⁵⁴ However, it was also noted that the issue might be revisited in the future, given the fact that the limitations on disclosure were put in place to preserve "procedural integrity" and not necessarily to ensure confidentiality *per se*.⁵⁵ Finally, with regard to the request to open the proceedings, the Tribunal reasoned that Rule

⁵⁰*Ibid.*, at 11.

⁵¹The Claimant's response is referred to in *Biwater Gauff Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Procedural Order No. 5 (*Biwater* Procedural Order No. 5), 2 February 2007, <http://icsid.worldbank.org>.

⁵²*Biwater* Procedural Order No. 5.

⁵³*Ibid.*, at para. 50.

⁵⁴*Ibid.*, at para. 65.

⁵⁵*Ibid.*, at para. 66.

32.2 was very clear on this matter. As the Claimant had voiced its objection to opening the proceedings, the Tribunal had no option but to reject the request.⁵⁶

7.1.4 UNCITRAL: One Step Forward, Two Steps Back?

Although it was under UNCITRAL Rules that the Tribunal in *Methanex* first determined that it had the power to accept *amicus curiae* submissions, it is important to remember that Rule 15.1 which provides this power is discretionary and is subordinated to other provisions in the Rules (the requirements that hearings will be held *in camera* unless the parties agree otherwise,⁵⁷ and that the award may only be made public with the consent of both parties⁵⁸). Some observers argue that the power to consider *amicus curiae* submissions should be made explicit, mandatory, and coupled with increased transparency.⁵⁹

In 2006, at its thirty-ninth session, UNCITRAL agreed that its Working Group II on International Arbitration and Conciliation should prioritize the revision of the UNCITRAL Arbitration Rules. In a Note prepared by the Secretariat, several possible amendments were contemplated. Of relevance here are the following options for consideration: an express provision on third party intervention; explicit rules regarding the confidentiality of the proceedings as such, or of the materials (including pleadings) before an arbitral tribunal; and rules addressing the situation where a party is under a legal duty to disclose an award or its tenor (for example under access to information legislation).⁶⁰ It would seem from this Note that it is possible that the revision of UNCITRAL Rules could make them more, or less, transparent.

In September of the same year, an unofficial report was released by UNCITRAL, authored by two investment arbitration experts, with more specific recommendations for the revision of the Rules.⁶¹ In terms of the express provision on third

⁵⁶*Ibid.*, at para. 70-2.

⁵⁷UNCITRAL Rules, at Rule 25.4.

⁵⁸*Ibid.*, at Rule 32.5.

⁵⁹See Marshall and Mann 2006.

⁶⁰United Nations Commission on International Trade Law Working Group II (Arbitration) Forty-fifth session Vienna, 11-15 September 2006, A/CN.9/WG.II/WP.143, <http://www.uncitral.org>.

⁶¹Paulsson and Petrochilos 2006.

party access, the report recommended inserting a new Rule 15.5 that would read:

Unless the parties have agreed otherwise, the Arbitral Tribunal may, after having consulted with the parties, and especially in cases raising issues of public interest, allow any person who is not a party to the proceedings to present one or more written statements, provided that the Tribunal is satisfied that such statements are likely to assist it in the determination of a factual or legal issue related to the proceeding by bringing a perspective, particular knowledge or insight which the parties are unable to present. The Arbitral Tribunal shall determine the mode and number of such statements after consulting with the parties.⁶²

With regard to the inclusion of an explicit confidentiality clause, the authors noted that there had been substantial discussion on this issue during the revision of the ICC Rules in 1998. In that case, it was decided that a general clause should not be included and that tribunals should make these decisions on a case-by-case basis. However, with regard to the documents and evidence produced in the course of the arbitration, the authors did feel the need to propose a new clause, which would state that:

Unless the parties have agreed otherwise, all materials in the proceedings which are not otherwise in the public domain, including materials created for the purpose of the arbitration and all other documents or evidence given by a party, witness, expert, [or any other person,] *shall be treated as confidential*, save and to the extent that disclosure may be required of a party by legal duty, to protect or pursue a legal right, and in bona fide legal proceedings before a state court or other judicial authority in relation to an award.⁶³

Finally, the report suggested an amendment to the clause on the publication of the award to allow for publication with the consent of both parties (as before) or when “disclosure is required of a party by legal duty, to protect or pursue a legal right or in relation to [bona fide] legal proceedings before a State court or other judicial authority.”⁶⁴ This clearly does not go as far as the ICSID Rules, where either party is permitted to publish the award unilaterally.

⁶²*Ibid.*, at 72.

⁶³*Ibid.*, at 79, emphasis added.

⁶⁴*Ibid.*, at 135.

Two NGOs, which have been involved as *amici* in several investor-state disputes, also made a proposal to UNCITRAL, in which they argued that a separate set of arbitration rules should be developed to govern disputes that involve a state as a party. One of their suggestions was that in this separate set of rules, acceptance of *amicus curiae* briefs should be made explicit through a new Rule 15.4 along the lines of Rule 37.2 of the new ICSID Rules and the NAFTA FTC guidelines.⁶⁵ The NGO report also strongly cautioned against the adoption of a confidentiality clause, stating that in the case of proceedings involving a state, such a clause “would fly in the face of principles of good governance and human rights, and thus undermine the credibility and legitimacy of the arbitral proceedings.”⁶⁶ Furthermore, the report argued that such a restraint on transparency would render effective third party participation impossible:

... a non-disputing party requesting leave to submit an *amicus curiae* brief to a tribunal could not elaborate on whether its perspective, knowledge or insight is different from the disputing parties’ or useful to the tribunal, if the record remains secret. Likewise, it would be impossible for a non-disputing party to prepare a submission within the scope of the dispute when access to pleadings is denied.⁶⁷

In February 2007, member-governments rejected the idea of including a general provision on confidentiality in the UNCITRAL Rules, but delayed the decision on whether or not to develop a separate set of rules for disputes involving states.⁶⁸ The revision of the UNCITRAL Rules is expected to be finalized in 2008.⁶⁹

7.1.5 Not Only for NGOs

It is important to understand that third party participation is not restricted to environmental or other advocacy groups. An ICSID discussion paper has noted this:

⁶⁵CIEL and IISD 2007, at 4.

⁶⁶*Ibid.*, at 10.

⁶⁷*Ibid.*

⁶⁸“Governments Punt Discussion of Special UNCITRAL Rules for Investor-State Disputes,” *Investment Treaty News*, 14 February 2007, <http://www.iisd.org/investment/itn>.

⁶⁹*Ibid.*

There may well be cases where the process could be strengthened by submissions of third parties, not only civil society organizations but also for instance business groups or, in investment treaty arbitrations, the other states parties to the treaties concerned.⁷⁰

A currently-pending NAFTA Chapter 11 case - *Glamis Gold v. United States* (see Section 5.3.1) - illustrates this. Four *amicus curiae* submissions have been filed in this case: the first by the Quechan Indian Nation in August 2004; the second, a joint submission of two NGOs (FOE-Canada and FOE-US), in September 2005; the third by the National Mining Association in October 2006; and the fourth, another joint submission of two NGOs (Sierra Club and Earthworks), also in October 2006.⁷¹

The power of the Tribunal to accept *amicus curiae* submissions was never in question, as the proceedings began following the release of the NAFTA FTC guidelines on third party participation. What is worthy of note about this case is that, for the first time, a business association (rather than a labour, environmental, or other social organization) requested permission to submit a brief. The National Mining Association is comprised of more than 325 corporations from the American mining sector, and its purpose is to advocate “public policies designed to protect and expand domestic mining opportunities that are of vital importance to the United States’ economic prosperity and national security.”⁷² While generally *amicus curiae* submissions are thought to be impartial and intended to provide perspective, expertise and arguments rather than direct support for either party, the National Mining Association application to file a submission states outright that it is “in support of the Claimant.”⁷³ The Association also has direct ties with the Claimant, as Glamis Gold Ltd. is an Association Member.

⁷⁰ICSID 2004, at 9.

⁷¹All of the petitions and submissions can be found on the *NAFTA Claims website*, <http://www.naftaclaims.com>.

⁷²*Glamis Gold Ltd. v. United States of America*, Application for Leave to File a Non-Disputing Party Submission by the National Mining Association, 13 October 2006, at 1, <http://www.naftaclaims.com>

⁷³*Ibid.*

7.1.6 Discussion

Those who argue in favour of increased transparency and third party participation suggest that due to the public-interest nature of investor-state disputes, the confidentiality that applies to private firm-firm disputes is inappropriate. As Legum notes, there are in fact a number of different kinds of ‘interest’ implicated in investor-state disputes, including:

... specific interest in the measure that is challenged in the case; general interest in the appropriate functioning of the investment protections; interest in the domestic law analogues of the treaty provision invoked [e.g., regulatory takings]; interest in the appropriate interaction between federal, state and local government authorities; and many others.⁷⁴

There are also several different types of ‘public’. Mistelis argues that in addition to the “general public,” which has an interest in investment disputes, there is also the “specialist public” (practicing lawyers and academics), which also has an interest in knowing how treaty provisions are interpreted by arbitration tribunals.⁷⁵ Limiting disclosure effectively privileges a small subset of the specialist public (arbitrators and lawyers participating in cases) whilst increasing transparency would expand the range of actors which could potentially participate in and report on disputes.

Some observers take issue with the notion that the existence of a ‘public interest’ justifies third party participation. In this view, it is the respondent state that should act in the public interest, and there is no further need for any other actor to do so. Some take this argument even further by questioning the legitimacy of NGOs to act in the public interest in the first place. Brower, for example, suggests that “many NGOs have very specific agendas and are not accountable to their own members, much less to the general public.”⁷⁶

However, even if NGOs do not represent the public interest, other arguments have been made in favour of third party participation. One is that third party participation can improve arbitral decisions by adding an extra layer of expertise

⁷⁴Legum 2003, at 145.

⁷⁵Mistelis 2005, at 230.

⁷⁶Brower 2003, at 73. See also Knahr 2007, at 327.

or perspectives on issues that would not be provided by the disputing parties.⁷⁷ The counter-argument to this is that interested third parties can petition the parties to the dispute directly to make claims on their behalf. However, there does seem to be a value in maintaining the independence of non-state actors in the process.⁷⁸

One of the most salient claims of those who support third party participation is that it may help to allay public disquiet about ‘secret trade courts’,⁷⁹ and contribute to a higher level of accountability in the arbitration process. Many authors believe that investment arbitration is either in, or is heading for, a serious legitimacy crisis.⁸⁰ In several of the cases discussed above, the tribunals noted the potential benefits of providing greater openness as well as the potential negative implications of not doing so. While this argument may hold when one is defending increased transparency in arbitration, it may be questioned whether the participation of private actors (which are not accountable to the public) actually increases the legitimacy of investment arbitration.

There appears to be a significant amount of support for the participation of *amici*, and for increased transparency, from states and outside observers. Nonetheless, there are still those who do not view the trends in this area as positive. Cook notes that confidentiality serves the parties’ interests in several ways:

By keeping proceedings confidential, parties are able to keep allegations of bad faith and bad business practices from the public, thus enabling the party to maintain a good business reputation. Furthermore, the public remains unaware of losses suffered resulting from adverse tribunal decisions. In addition, party autonomy inherent in arbitral proceedings allows parties to agree on the level of confidentiality so that they are able to keep from the public, and sometimes the other party, information critical to the livelihood of a business like trade secrets and other sensitive business information.⁸¹

However, it can be argued that information about bad business practices is precisely what the public should have privy to, and that ‘trade secrets’ can be dealt

⁷⁷Buckley and Blyschak 2007, at 360.

⁷⁸See Mistelis 2005, at 223.

⁷⁹As an editorial famously termed them; see “The Secret Trade Courts,” *New York Times*, 27 September 2004.

⁸⁰Afilalo 2004; Atik 2004; Brower 2003; Franck 2005.

⁸¹Cook 2007, at 1100.

with quite easily, as it is in other fora, by redaction in documents released to the public and *in camera* restrictions when discussions of this nature arise in the proceedings.

Another criticism of third party participation is that it will increase the length and cost of arbitration.⁸² Investor-state disputes already run, on average, several years and entail substantial costs for both claimants and respondent states. However, there are two counter-arguments here: (i) the cost and delay in proceedings can be minimized by clear procedures for when and how *amici* may participate (e.g., only in the merits phase, limits to length of submission, etc.); and (ii) the tribunal is receiving additional information at no direct cost to either party (as *amici*, unlike experts, are not remunerated for their services).⁸³

Related to the issues of the cost and the time burden to the parties is the notion that allowing third party participation will ‘open the floodgates’ to a large number of submissions. However, this is unlikely to occur in practice; there has been no flood of submissions in the WTO or in other bodies that accept *amicus curiae* briefs, and the experience thus far in investment disputes suggests that, in fact, NGOs are likely to make joint submissions rather than duplicative ones.

A further argument that has been made against the participation of third parties is that it is unfair and that it may upset the balance between the positions of the respondent and claimant by favouring one side. Again there are several key counter-arguments: (i) in theory, *amici* are meant to provide information which is impartial, and not to intentionally support one party to the dispute;⁸⁴ (ii) even if, in practice, *amicus curiae* submissions do support the position of one of the parties, this does not mean that the tribunal will necessarily give more weight to that party’s position;⁸⁵ and (iii) while it is usually argued that the participation of *amici* unfairly favours the respondent state, the *Glamis Gold* case illustrates that, in practice, *amici* may intervene to support the claimant as well.

The position of the Claimant in *Biwater* indicates a further argument against greater transparency and disclosure. This is the notion that opening up arbitration

⁸²Knahr 2007, at 351-2.

⁸³See Bennaim-Selvi 2005, at 804.

⁸⁴Judge Posner, qtd. in Ford 2005, at 239, states that, “[t]he term ‘*amicus curiae*’ means friend of the court, not friend of a party.”

⁸⁵Bennaim-Selvi 2005, at 805.

to the ‘court’ of public opinion will lead to the ‘re-politicization’ of investor-state disputes.⁸⁶ While in *Biwater* it was the investor that was concerned about negative publicity, Rubins suggests that the re-politicization of disputes is likely to be most costly for the host state, which runs the risk of losing credibility as an investor-friendly country.⁸⁷ This is likely to be an issue of particular concern for developing countries. Egonu notes that in *Amco v. Indonesia*, an early ICSID case, Indonesia requested confidentiality because the government was concerned that negative publicity related to the case might discourage foreign investment in the country.⁸⁸ In *Metalclad*, the respondent country (Mexico) also argued for confidentiality in the proceedings.⁸⁹ However, an obvious counter-argument is that some information about investor-state disputes is likely to reach the public domain whether investment arbitration is open or not. Increased transparency will result in the public having access to more accurate and balanced information, thus decreasing the opportunity for smear campaigns against either the respondent state or the claimant.

Finally, it should be mentioned that the notion of permitting *amicus curiae* submissions has also been viewed with some skepticism in the developing world, and not only because of concerns about the increased burden on the parties to the dispute in terms of the financial and reputational costs of arbitral proceedings. The South Centre, an intergovernmental body of developing countries, argues that “[p]ermitting amicus submissions effectively disadvantages developing countries because the civil society and industrial organisations in the developed countries are more experienced, better organised and equipped as well as better funded.”⁹⁰ A counter argument would be that, as was the case in both the Argentinean and Tanzanian examples, local NGOs can benefit from support and cooperation with Northern-based NGOs, which can provide expertise in the highly specialized area of investment arbitration.

Table 7.2 summarizes the main arguments for and against transparency and the participation of third parties in investor-state disputes, as well as the counter-

⁸⁶Rubins 2006.

⁸⁷*Ibid.*

⁸⁸Egonu 2007, at 485.

⁸⁹*Ibid.*

⁹⁰South Centre 2005, at 10.

arguments to each.

7.2 ‘Re-Modeled’ Agreements

As mentioned previously, several countries have recently introduced new versions of their model BITs and have negotiated agreements based on these revised models. In addition to including changes to arbitration procedures, several agreements also incorporate substantive changes relevant to the issues of concern in this study. According to UNCTAD, the increase in investor-state disputes is “one of the main reasons why some countries seek to clarify individual BIT provisions with a view to reducing the risk of disputes in the future.”⁹¹ Similarly, Gagné and Morin argue that the changes to the US Model BIT reflect that the government has learned from its experience in the NAFTA, and now aims “to reach a better balance between the protection of investment and the protection of state sovereignty.”⁹²

7.2.1 Preambles

There are several ways in which concerns about the protection of the environment have been incorporated into the texts of agreements. Preambular statements are one way. For example, the US Model BIT states in the preamble that the Parties are: “Desiring to achieve these objectives in a manner consistent with the protection of health, safety, and the environment.”

However, this practice is not widespread, even in recent treaties. Newcombe reviewed 71 BITs dated between 2001 and 2005 and found very limited reference to sustainable development or the environment in the preambles of these agreements.⁹³ However, he notes that FTAs are more likely to have such preambular statements.⁹⁴

⁹¹UNCTAD 2007, at 1.

⁹²Gagné and Morin 2006, at 359.

⁹³Newcombe 2007a, at 399.

⁹⁴*Ibid.*

Table 7.2: Arguments and Counterarguments For and Against Transparency and Third Party Participation

	<i>Argument</i>	<i>Counterargument</i>
<i>In favour of third party participation</i>	Public interest / public purse	Respondent state represents the public interest; NGOs not accountable
	<i>Amici</i> can provide knowledge, expertise, or different perspectives	Third parties can petition one of the parties directly and can be called on as experts
	Allay public fears about secretive nature of arbitration (increase legitimacy)	Questionable whether the participation of actors, which are not accountable to the public, can increase legitimacy
<i>Opposed to third party participation</i>	Trade secrets	Can still be kept secret (redaction, partial <i>in camera</i>)
	Increases burden in time and cost	Burden is minimal, and can be controlled through set guidelines on participation; the tribunal obtains more information at no direct cost (<i>amici</i> not paid)
	Opens the floodgates	No evidence of this in WTO or other settings, or in recent investment arbitration practice
	Unfair to one party	Third parties may participate to support either the claimant or the respondent state; tribunals do not weigh arguments more heavily just because more parties make them
	Re-politicizes disputes	Greater transparency and the involvement of third parties leads to more balanced representation of the case in the public sphere
	Northern actors/organizations more capable of intervening than Southern ones	Southern/local actors/organizations have intervened in several cases; Northern actors / organizations can support Southern ones and increase their capacity to act as <i>amici</i>

7.2.2 Consistency and Pollution Havens Provisions

General statements on the adoption and/or enforcement of environmental laws generally come in two forms, which are referred to here as ‘consistency provisions’, and ‘pollution havens provisions’.

Consistency provisions are statements which reiterate that governments are not prevented from adopting or enforcing environmental regulations which are *otherwise consistent* with the rest of the agreement. For example, the US Model BIT states that:

Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.⁹⁵

This provision is not novel; it copies Article 1114.1 of the NAFTA. The ‘otherwise consistent’ wording has led some observers to conclude that this type of provision is solely tautological, and has no practical meaning whatsoever.⁹⁶ Baughen also notes the weakness of the phrase “sensitive to environmental concerns.”⁹⁷ An UNCTAD report concludes that these types of provisions are mainly explanatory and meant as “a tool for sending a message to civil societies that the contracting parties take environmental concerns into account.”⁹⁸

Pollution havens provisions are statements discouraging countries from lowering environmental standards to attract investment. For example, the 2003 Canadian Model FIPA states that:

The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor. If a Party considers that the other Party has offered such

⁹⁵US Model BIT, at Art. 12.2. This provision has been incorporated into all new US BITs and FTAs, including the: CAFTA-DR, at Art. 10.11; US-Chile FTA, at Art. 10.12; US-Uruguay BIT, at Art. 12.2; and US-Australia FTA, at Art. 11.11.

⁹⁶Newcombe 2007a, at 400; Freedman 2003, at 94.

⁹⁷Baughen 2006, at 222.

⁹⁸UNCTAD 2007, at 89.

an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.⁹⁹

Again, this text has been drawn from the NAFTA (Article 1114.2). The CAFTA-DR has slightly stronger wording:

- a. A Party shall not fail to effectively enforce its environmental laws, through a sustained or recurring course of action or inaction, in a manner affecting trade between the Parties, after the date of entry into force of this Agreement.
- b. The Parties recognize that each Party retains the right to exercise discretion with respect to investigatory, prosecutorial, regulatory, and compliance matters and to make decisions regarding the allocation of resources to enforcement with respect to other environmental matters determined to have higher priorities. Accordingly, the Parties understand that a Party is in compliance with subparagraph (a) where a course of action or inaction reflects a reasonable exercise of such discretion, or results from a bona fide decision regarding the allocation of resources.¹⁰⁰

It is further stated in the CAFTA-DR that:

The Parties recognize that it is inappropriate to encourage trade or investment by weakening or reducing the protections afforded in domestic environmental laws. Accordingly, each Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such laws in a manner that weakens or reduces the protections afforded in those laws as an encouragement for trade with another Party, or as an encouragement for the establishment, acquisition, expansion, or retention of an investment in its territory.¹⁰¹

The 2004 US Model BIT contains the same wording.¹⁰² Interestingly, the proposed FTAA additionally provides that:

⁹⁹Canadian Model FIPA, at Art. 11.

¹⁰⁰CAFTA-DR, at Art. 1017.1.

¹⁰¹*Ibid.*, at art. 1017.2.

¹⁰²US model BIT, at Art. 12.1.

[For smaller economies, a commitment not to relax domestic environmental laws should be allied with compensating access to the Hemispheric Cooperation Program for the purpose of introducing more modern machinery and industrial practices that would better protect the environment.]¹⁰³

Freedman comments that the use of the terms such as ‘should’ in pollution havens provisions “denotes a precatory, non-binding commitment, whose breach can give rise to no more than consultations among the Parties.”¹⁰⁴ Hasic similarly argues that the language in the NAFTA pollution havens provision “is simply not forceful enough to convey the impression of a serious commitment.”¹⁰⁵ Finally, Cléménçon, commenting on the Draft MAI pollution havens provision, also expresses doubts about the value of such statements:

It is important to recognize the limitation of such a provision - binding or non-binding. It would, in most cases, be impossible to prove that a country in effect had lowered environmental standards for the sole purpose of accommodating a particular foreign investor. Furthermore, such a provision does not address the problem that adequate environmental standards have still not been developed in many countries.¹⁰⁶

7.2.3 Chapters on the Environment

The US has recently negotiated several FTAs which, in addition to containing chapters on investment, also contain chapters on the environment. In relation to investment, these environment chapters generally contain pollution havens type provisions, but unlike standard BITs, these provisions are backed up by an enforcement mechanism. Parties may request the establishment of an arbitration panel to consider instances of a breach of the obligation to enforce environmental laws, which can impose an annual monetary fee of up to US \$15 million per year, payable into a bilateral fund for environmental initiatives.¹⁰⁷ The FTAs also

¹⁰³Draft FTAA, at Art. 1719.2.

¹⁰⁴Freedman 2003, at 94.

¹⁰⁵Hasic 2005, at 154.

¹⁰⁶Cléménçon 2000, at 218.

¹⁰⁷US-Singapore FTA, at Art. 20.7; US-Chile FTA, at Art. 22.16; US-Australia FTA, at Art. 21.12; CAFTA-DR, at Art. 20.17; Morocco FTA, at Art. 20.12.

provide that in the event of inconsistency between the investment chapter of the agreement and the environment chapter, the latter shall prevail.¹⁰⁸ However, as Gagné and Morin are quick to point out:

It is still unclear when an inconsistency between the two chapters can occur because a state can be forced under the labour and environment chapters to enforce a law discriminating against foreign investments and, at the same time, be forced under the investment chapter to offer monetary damages to foreign investors.¹⁰⁹

The authors hypothesize that the environment chapter may at least influence negotiations between an investor and a host state, because states will not want to risk an international dispute with another state over the non-enforcement of an environmental law. However, this claim seems somewhat dubious. One can question whether states will be willing to bring other states before arbitration for non-enforcement of environmental law, when they risk the mechanism being used against them in turn. Much like the side agreement to the NAFTA, the environment chapters in recent FTAs are largely an exercise in public relations, intended to dispel some of the disquiet which surround the negotiations of trade and investment agreements.

7.2.4 Clarifications

Clarifications flesh out some of the detail of vaguely worded regulative norms and rules of investment protection. They are an attempt to reduce uncertainty about how government or court actions, including those related to the protection of the environment, will be interpreted by arbitrators.

As noted previously, the NAFTA Parties published the Notes of Interpretation to clarify the meaning of the international minimum standard/fair and equitable treatment. The clarification of this provision has also been carried over into Canadian and American BITs and FTAs. The US Model BIT clarifies that the minimum standard of treatment does not entail anything beyond that provided for in customary international law. It further defines fair and equitable treatment as including

¹⁰⁸US-Singapore FTA, at Art. 15.2; US-Chile FTA, at Art. 10.2; US-Australia FTA, at Art. 11.2; CAFTA-DR, at Art. 10.2; US-Morocco FTA, at Art. 10.2.

¹⁰⁹Gagné and Morin 2006, at 379-81.

“the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world,” and explicitly spells out that a “determination that there has been a breach of another provision of this Treaty, or of a separate international agreement, does not establish that there has been a breach of this Article.”¹¹⁰ In addition, an annex is included in the Model, which defines customary international law as resulting “from a general and consistent practice of States that they follow from a sense of legal obligation” and specifies that the minimum standard refers “to all customary international law principles that protect the economic rights and interests of aliens.” The Canadian Model FIPA also stipulates that the minimum standard only requires treatment in line with customary international law, and that a breach of another provision or agreement does not establish a breach of the standard, although it does not have an annex on the issue.¹¹¹

In terms of clarification of expropriation provisions, the US Model BIT and the Canadian Model FIPA both have an annex on the issue, which lays out a three-part test for the determination, on a case-by-case basis, of whether an indirect expropriation has occurred. The factors that are to be considered are: the economic impact of the government action; the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and the character of the government action.¹¹² The three-part test is drawn from American takings jurisprudence.¹¹³ The US Model BIT Annex has a provision which states that

Except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to achieve legitimate public welfare objectives, such as the protection of public health, safety, and the environment, do not constitute indirect expropriations.¹¹⁴

The Canadian Model FIPA contains a similar statement.¹¹⁵

Gantz views the annexes as a “truly remarkable effort to provide detailed guidance to future tribunals seeking to distinguish compensable expropriations from

¹¹⁰US Model BIT, at Art. 5.2 and 5.3.

¹¹¹Canadian Model FIPA, at Art. 5.

¹¹²US Model BIT, at Annex B.4(a); Canadian Model FIPA, at Annex B.13(1).

¹¹³Muse-Fisher 2007, at 509; Parisi 2005, at 417.

¹¹⁴US Model BIT, at Annex B.4(b).

¹¹⁵Canadian Model FIPA, at Annex B.13(1)(c).

valid government regulations,” and suggests that they “unquestionably will make it more difficult for a foreign investor to claim successfully that any sort of government regulatory action is an expropriation, particularly if the regulatory action has any environmental or public health nexus.”¹¹⁶ Others are less optimistic, and argue that the three-part test is too vague, and is outdated in relation to both domestic and international jurisprudence.¹¹⁷ In respect of the latter, it has been pointed out by Edsall that “the language of the annex implies that the factors to be taken into account must be balanced against each other, rather than considered in the hierarchical analysis that the *Methanex* Tribunal applied.”¹¹⁸ Similarly, Parisi suggests that the annex misses:

... critical limitations stating that an investor’s expectations are a necessary, but not sufficient, condition for liability, that an investor’s expectations must be evaluated as of the time of the investment or that an investor must expect that health, safety, and environmental regulations often change and become more strict over time.¹¹⁹

It has also been suggested that the use of the broad and vague “rare circumstances” terminology will only encourage lawyers to develop creative arguments to test the boundaries of the exception, which will increase, rather than limit, uncertainty.¹²⁰

7.3 Environmental Impact Assessments

The new generation of BITs and FTAs described above, have been negotiated under increased scrutiny. In the US and Canada, this scrutiny has included formal assessments of the environmental impacts of the agreements.

7.3.1 United States

The development of the 2004 US Model BIT, and the subsequent negotiation of BITs and FTAs following this model, was within the broader framework of a

¹¹⁶Gantz 2004, at 744-5.

¹¹⁷Muse-Fisher 2007, at 509.

¹¹⁸Edsall 2006, at 957.

¹¹⁹Parisi 2005, at 421-2.

¹²⁰Edsall 2006, at 958-9.

new Bipartisan Trade Promotion Authority Act of 2002 (TPA). The TPA was developed, in part, to address concerns relating to the investor-state dispute settlement process in trade agreements like the NAFTA. Investment provisions, and the question of the appropriate balance between investment protection and the ability of government to regulate, were reportedly “a matter of intense debate” during Congress’ consideration of the TPA.¹²¹

The TPA established a number of negotiating objectives and other priorities relating to the environment. Under the TPA and following a framework outlined in Executive Order 13141, all new investment and trade agreements are to undergo an EIA.¹²² It is stipulated that “as a general matter, the focus of environmental reviews will be impacts in the United States, [but] [a]s appropriate and prudent, reviews may also examine global and transboundary impacts.”¹²³ Generally, reviews address two types of questions: (i) the extent to which positive and negative environmental impacts may flow from economic changes estimated to result from the prospective agreement; and (ii) the extent to which proposed agreement provisions may affect US environmental laws and regulations (including, as appropriate, the ability of state, local and tribal authorities to regulate with respect to environmental matters).

The Office of the US Trade Representative (USTR) conducted a number of FTA environmental reviews in 2004. All of the reports emanating from the assessments concluded that there would be no significant impact of the investment provisions of the agreements on the environment. For example, the authors of the review of the CAFTA-DR claim that they, “were unable to identify any concrete instances of US environmental measures that would be inconsistent with the Agreement’s substantive investment obligations.”¹²⁴ Furthermore, the report notes that the innovations in the agreement’s substantive obligations and investor-state dispute settlement procedures, “should provide coherence to the interpretation of the FTA’s investment provisions.”¹²⁵ The reviewers do acknowledge that

¹²¹Final Environmental Review of the CAFTA-DR, 22 February 2005, at 29, <http://www.ustr.gov>.

¹²²Environmental Review of Trade Agreements, 64 Fed. Reg. 63169, and the Associated Guidelines, 65 Fed. Reg. 79442, <http://www.ustr.gov>.

¹²³Executive Order 13141, at Section 5(b).

¹²⁴CAFTA-DR Final Environmental Review, at 2.

¹²⁵*Ibid.*

the CAFTA-DR might have a greater impact on the *other states* party to the agreement, but suggest that the specific environmental implications cannot currently be predicted. Similarly, the review of the US-Chile FTA concluded that the agreement, “would not significantly affect the ability of U.S. governmental entities to regulate in order to meet domestic health, safety, and environmental policy objectives,” and noted that the revisions of the investment provisions:

provide greater clarity to the substantive investment obligations, significantly increase the transparency of the procedures for arbitrating investor claims, and help ensure that arbitral tribunals will interpret the investment provisions in accordance with the Parties’ intent.¹²⁶

The same conclusions are reached in the review of the US-Singapore FTA, and the US-Morocco FTA.¹²⁷

7.3.2 Canada

In 1999, a Cabinet Directive on Environmental Assessment of Policy, Plan and Program Proposals was promulgated, leading to the development of the 2001 Framework for the Environmental Assessment of Trade Negotiations. This framework covers Canada’s FIPA program. According to the government website:

The Canadian government is committed to integrating sustainable development into domestic and foreign policy, and the environmental assessment of trade and investment negotiations is one mechanism for doing so. We are therefore committed to conducting environmental assessments (EAs) of trade negotiations using a process that requires interdepartmental coordination along with public and stakeholder consultations, including provincial and territorial governments.¹²⁸

¹²⁶Final Environmental Review of the U.S.-Chile Free Trade Agreement, June 2003, at 5, <http://www.ustr.gov>.

¹²⁷Final Environmental Review of the U.S.-Singapore Free Trade Agreement, 2003; Final Environmental Review of the United States-Morocco Free Trade Agreement, July 2004, <http://www.ustr.gov>.

¹²⁸“Regional and Bilateral Initiatives,” *Canadian Department of Foreign Affairs and International Trade website*, <http://www.dfait-maeci.gc.ca>, accessed 29 August 2007.

Increased coordination between ministries and agencies may be the most significant outcome of the program. As noted in Sections 5.5.3 and 6.3.2, investor-state disputes can create tension between levels and sectors of governance. Involving environmental ministries and provincial and municipal governments in the IIA negotiation process reduces the risk of this to some degree. Furthermore, if effective, it could contribute to increased policy coherence, which will decrease the likelihood that investor-state conflicts will arise in the first place.

The FIPA with Peru was the first to be evaluated under the program. Negotiations on the agreement re-commenced in December 2003, following a hiatus of several years, and were based on the new Model FIPA. An initial EIA was released for public comment in 2005.¹²⁹ The methodology of the assessment is to identify “the likely economic effects of the FIPA and, on this basis, [draw] conclusions about the potential environmental impacts *in Canada*.”¹³⁰ The report notes that Peru’s total investment in Canada is small, at only CDN\$1 million in 2003, and suggests that the FIPA is not likely to change this situation significantly. On the other hand, the stock of Canadian foreign investment in Peru is significant, totaling CDN\$1,790 million in 2003. The majority of this investment was in the mineral sector, an industry well-known for its environmental impact. While the assessment does not rule out the possibility that Canadian investment in Peru may increase, it suggests that the protection of *existing* Canadian investment in the country is likely to be the main effect of the FIPA.

As noted in the report, “it is outside of the scope” of the study “to assess the potential for positive or negative environmental impacts that could occur in Peru because of these negotiations, or to judge the measures in place within Peru to enhance or mitigate such impacts.” The Initial Environmental Assessment concludes that “significant changes to investment flows into Canada are not expected as a result of these negotiations” and therefore “the economic effects and resulting environmental impact in Canada are expected to be minimal to non-existent.” The assessment also concludes that the FIPA “will not have a negative effect on Canada’s ability to develop and implement environmental policies and regula-

¹²⁹ Initial Environmental Assessment of the Canada-Peru Foreign Investment Protection Agreement (FIPA), 2005, <http://www.international.gc.ca>.

¹³⁰ *Ibid.*, emphasis added.

tions.” The reasoning on this issue is based partly on the belief that the adjustments to the Model FIPA (used as a template for the Peru agreement) deal effectively with this issue, as well as the fact that it is not anticipated that the FIPA will result in significant inflows of investment into Canada from Peru (i.e. there will be no Peruvian investors to challenge Canada’s laws under the agreement).

Despite the fact that it is repeatedly emphasized throughout the Peru assessment that the only aim of the EIA is to consider environmental impacts occurring within Canada, or transboundary impacts that can be shown to impact Canada’s environment, the majority of public comments received by the committee responsible for the EIA pertained to the environmental impact of Canadian investment in Peru. While these comments were acknowledged, the negotiations for the Canada-Peru FIPA were concluded successfully on 14 November 2006, with no modification to the environment-related provisions of the FIPA model.

NGOs have expressed concern that the FIPA-EIA process is ignoring the fundamental issue of the impacts of Canadian investors abroad, but there has been no change as of yet in the protocol. The most recent FIPA to be evaluated (with India) came to largely the same conclusions as the Peru assessment; no significant investment flows to Canada, and therefore no significant environmental impact *for Canada*.¹³¹

7.4 Proposals for Moving Beyond Moderate Reform

Many observers who are critical of the institution of investment protection would not be satisfied with the types of moderate reform outlined above (acceptance of *amicus curiae*, clarifications, etc.). As such, proposals for more substantial reform have emerged in recent years. The section addresses several of these proposals and also examines the decision of some governments to opt out of the institution altogether.

¹³¹Initial Environmental Assessment (EA) of the Canada-India Foreign Investment Protection and Promotion Agreement (FIPA), 2007, <http://www.international.gc.ca>.

7.4.1 An Appellate Body or International Investment Court

While hardly revolutionary, the development of a system for appeals of investment arbitration awards would require significant initiative. It is perhaps the most frequently-recommended reform in the literature on investment arbitration, though it is not a universally-supported concept.¹³²

A permanent appellate body could ensure consistency in tribunal decisions and provide some predictability for regulators. As mentioned in Section 4.2.2, the only remedies that can be sought at present under ICSID, for example, are the interpretation of the meaning or scope of an award, the revision of an award based on the discovery of new information, or the annulment of an award. An annulment is only possible in rather extreme circumstances. The purpose of an appeal is also fundamentally different from that of annulment. In an appeal, a tribunal may reverse or substitute a new decision for the one appealed against, whereas in an annulment the tribunal may only nullify or invalidate a decision. An annulment committee is only concerned with the process leading to a tribunal decision, whereas an appellate panel is additionally concerned with the substantive correctness of an award.¹³³

Under other arbitration rules, review is possible in the courts in the seat of arbitration, but again, awards can only be overturned in a limited number of circumstances. Nevertheless, for some observers, it is the role of domestic courts in the review of awards that needs to be curtailed. Unhappy with what they view as interference in the arbitration system, proponents of an appellate mechanism argue that it would reduce or eliminate the ability of domestic courts to review awards.¹³⁴ For others observers, the aim of an appellate body is to deal with possible 'rogue' arbitral decisions.¹³⁵

The push for an appellate body appears particularly strong in the US. The TPA put an appellate mechanism on the list of negotiating objectives for future trade

¹³²In support see: Wells and Ahmed 2007; Franck 2005; Brower 2003; Dodge 2001a; Knull III and Rubins 2000.

¹³³Ekwueme 2006, at 187.

¹³⁴However, court review would also be eliminated by universal accession to the ICSID Convention. See: Coe 2002, at 206; Brower 2002, at 484-5.

¹³⁵Gantz 2006, at 43, referring to the reason for US Congress support for an appellate mechanism.

agreements, and recent FTAs like the US-Chile FTA, the US-Singapore FTA, and the US-Morocco FTA provide that the parties will consider the establishment of an appellate body within three years after the date of entry into force of the agreement.¹³⁶ The CAFTA-DR has a much more detailed provision on the development of an appellate mechanism, requiring the establishment of a negotiating group on the issue within three months of entry into force of the agreement.¹³⁷ Gantz notes that a CAFTA-DR appellate mechanism could be a “significant first step” toward a broader appellate body.¹³⁸ The CAFTA-DR also has a novel procedure for review in the absence of an appellate body; the parties may request that the tribunal submit to them its proposed award, prior to issuance, for comment.¹³⁹ As Cook notes, “[a] tribunal is more likely to be accommodating to the parties’ critiques of an award before it has been officially issued, and the parties will be less likely to challenge an award that they had a hand in shaping.”¹⁴⁰

ICSID also raised the issue of the development of an appellate body in a 2004 Discussion Paper.¹⁴¹ However, the comments that the ICSID Secretariat received from governments, business and civil society groups, generally indicated that the establishment of such a mechanism was premature.¹⁴²

One of the main problems with developing an appellate mechanism is that, if it is going to have any chance of enhancing the consistency of awards, it should bring all, or at least most, existing IIAs under its umbrella. With the prospects for a multilateral agreement on investment exceedingly dim, it is difficult to imagine how broad negotiations on the development of such a body could be initiated. Gantz notes further legal and practical challenges such as: the choice of the appropriate standard of review; the power of the appellate mechanism to confirm, set aside, and remand; issues relating to choice of law; the relationship of the appellate mechanism process to national court review; and transparency consider-

¹³⁶US-Chile FTA, at Annex 10-H; Side Letter to the US-Singapore FTA; US-Morocco FTA, at Annex 10-D.

¹³⁷CAFTA-DR, at Annex 10-F.

¹³⁸Gantz 2006, at 48.

¹³⁹CAFTA-DR, at Art. 1020.9.

¹⁴⁰Cook 2007, at 1125.

¹⁴¹ICSID 2004.

¹⁴²Gagné and Morin 2006, at 378.

ations.¹⁴³

As mentioned above, not all observers view an appellate mechanism as a solution to all, or even most, of the important problems with investment arbitration and it has been argued by some that such a mechanism will create new problems. From the perspective of investors, the main objection to an appellate mechanism is that it will slow the arbitration process down and give the outcome of a dispute less finality.¹⁴⁴ As Werner notes:

While it was recognized by the business community that arbitrators were just humans who could fail in their decisions, the consensus was that it was more important to have a one-stop shop, enabling the parties to put the disputes behind them once and for all without having to go through lengthy appeal proceedings.¹⁴⁵

Finality of awards may also be an issue for states, particularly in the NAFTA context where several awards have been decided in favour of states, and the US has yet to lose even one claim.¹⁴⁶ Furthermore Foy suggests that, in the NAFTA context at least, agreeing to an appellate body would require some further ceding of authority, given that at present the Parties possess the ability to issue their own interpretations of the agreement.¹⁴⁷

If the other problems inherent in investment arbitration (transparency, accountability etc.) are not dealt with prior to, or in concordance with, the development of an appellate body, it is hard to imagine that the issues for environmental governance that have been raised in this study would disappear. Rulings would likely become more predictable, but that doesn't mean that they would be consistent with the objectives of sustainable development. In this respect, Van Harten has a far more interesting proposal. Rather than advocating an appellate body, he suggests the adoption of a multilateral code that would establish an international investment court with comprehensive jurisdiction over the adjudication of investment claims.¹⁴⁸ In this model, judges would be appointed for set terms, which

¹⁴³Gantz 2006, at 57.

¹⁴⁴Goldhaber 2004.

¹⁴⁵Werner 2003, at 783.

¹⁴⁶Amirfar and Dreyer 2007, at 54.

¹⁴⁷Foy 2003, at 104-5.

¹⁴⁸Van Harten 2007a, at 180.

Van Harten attests is critical for making them independent, and they would be appointed by states, which is “essential to make them accountable.”¹⁴⁹ Van Harten counters the critics of state appointments, arguing that given “the experience of many other courts – which are staffed by talented and responsible jurists – we shall have to trust that states will not appoint nincompoops to an international investment court.”¹⁵⁰ He suggests that an international investment court would benefit both capital-importing and capital-exporting states:

For capital-importing countries, an international court in which they have some say in the appointment process is much preferable to a system of private arbitration, biased against host governments, in which they have little say at all. For the major capital-exporting states and their firms, the proposal asks them to sacrifice little in exchange for an international judicial body that is more likely to have political staying power than the current system.¹⁵¹

7.4.2 An Investment Agreement for Sustainable Development

While the proposal for an appellate body or investment court is intended to deal with the procedural failings of investment arbitration, other proposals for reform aim more squarely at addressing the imbalance between the rights and duties of investors, host states, and home states. There are two main approaches to addressing this imbalance, the ‘complementary approach’ of developing codes of investor conduct in parallel with IIAs, and the ‘consolidated approach’, which instead incorporates provisions on the responsibilities of foreign investors directly into IIAs.¹⁵²

While the complementary approach has largely prevailed in the modern period (see Section 2.2.3), the consolidated approach now appears to be gaining favour in some quarters. For example, Cléménçon notes that “a multilateral investment

¹⁴⁹ *Ibid.*, at 182.

¹⁵⁰ *Ibid.*

¹⁵¹ *Ibid.*, at 183.

¹⁵² Shan 2007, at 656-7.

agreement offers many opportunities for linking the pursuit of economic and development objectives directly with environmental protection objectives.”¹⁵³

The IISD has gone so far as to develop a Model International Investment Agreement for Sustainable Development.¹⁵⁴ The IISD Model Agreement makes many clarifications of the standard provisions on investment protection, several of which are similar to those mentioned above, but in addition there is clarification of ‘like circumstances’ with respect to national and most-favoured-nation treatment, requiring that the tribunal must take into account certain factors, including the effects of the investment on the environment.¹⁵⁵ The Model Agreement also delves into issues of procedural reform, and goes much further in this respect than the NAFTA or any other agreement. Importantly, it calls for the development of a standing roster of arbitrators, an appellate body, and a legal assistance centre.

However, far more innovative than the textual clarifications and procedural reforms in the IISD Model is the addition of a section on investor obligations as well as one on home state obligations. With regard to the environment, the obligations include compliance with environmental screening criteria and EIA procedures, and maintenance of an environmental management system (e.g., ISO 14000).¹⁵⁶ Such measures are, of course, open to criticism (see discussion in Section 2.2.3). On the most fundamental level one has to question whether these provisions will achieve anything more than the status quo. Many corporations already hold ISO 14000 certification, and EIAs are common procedures in many developing countries and are requirements in any projects funded or insured by the World Bank Group. As Leubuscher points out, EIAs in developing countries are typically carried out by private consultancies paid for by the investor, in some cases with limited reference to peer-reviewed literature and questionable methodology.¹⁵⁷ Difficulty also lies in the monitoring and enforcement of environmental regulations after the project has been initiated.¹⁵⁸ As an NGO report points out, the IISD

¹⁵³ Clémenton 2000, at 205.

¹⁵⁴ IISD Model International Investment Agreement for Sustainable Development, 2005, http://www.iisd.org/investment/model_agreement.asp.

¹⁵⁵ IISD Model Agreement, at Art. 5E.

¹⁵⁶ *Ibid.*, at Art. 12 and 14.

¹⁵⁷ Leubuscher 2004, at 281.

¹⁵⁸ Onwuekwe 2006, at 121.

model also fails to give civil society any significant new powers and only requires that governments set up national contact points for investigations into concerns raised by individuals or civil society groups about investor conduct.¹⁵⁹

A writer from the NGO Public Citizen has stated that the IISD Model “is an attempt to create a ‘kinder, gentler’ version of the same bad rules.”¹⁶⁰ But even if one makes a less harsh assessment of the IISD Model, a further crucial question to be raised is whether it is realistic. As Wade points out, “[i]t is easy to say that ‘the international economic regime must be changed, developing countries should be given...’ but “[t]he politics are another matter.”¹⁶¹ History tells the same story; given the fate of both the UNCTC and the MAI, one would have to expect that there would be a concerted lobbying effort on the part of the business community to tank the proposal for a sustainable investment agreement if one were ever seriously contemplated. William A. Reinsch, President of the National Foreign Trade Council, has commented that the requirement in the IISD Model to exhaust domestic remedies before accessing arbitration would create a formidable hurdle to foreign investors, since “the domestic judicial system in many developing countries is corrupt, inefficient, and/or inexperienced.” He further states that “it is not a corporation’s responsibility to act as a shadow government, as it would have to under this model agreement.”¹⁶²

Given the position of the business lobby, there is likely to be opposition from developed countries to any new project for the adoption of a sustainable investment agreement, but a further stumbling block is the current position of developing countries. Cho and Dubash argue that the posture of developing countries in the negotiation of a multilateral agreement on investment in the WTO is “strictly defensive” and suggest that “the refusal to negotiate is a tactic that may miss potential opportunities for integrating investment into a sustainable development agenda.”¹⁶³ In addition to the poor prognosis for the IISD Model being adopted, there is also the issue of whether, if it were adopted, it would actually *replace* the existing bilateral and regional arrangements, or rather add yet another layer of

¹⁵⁹Anderson and Grusky 2007, at 25.

¹⁶⁰*Ibid.*

¹⁶¹Wade 2005, at 98.

¹⁶²Qtd. in Anderson and Grusky 2007, at 25.

¹⁶³Cho and Dubash 2005, at 175-6.

governance to an already complex and confusing system.

Salgado concludes that the IISD Model is “not a panacea to all legal challenges in international investment law,” but is certainly “the best alternative currently available.”¹⁶⁴ Most significantly, while it is unlikely to be adopted at the multilateral level in the near future, it may have value as a template for the development of more balanced bilateral and regional agreements.¹⁶⁵

While the IISD Model is perhaps the best known initiative in the area, it is not the only one. The Venezuelan government has also proposed its own alternative trade and investment agreement. The Alternativa Bolivariana para las Américas (ALBA) is an international cooperation organization based upon the idea of social, political, and economic integration between the countries of Latin America and the Caribbean. Largely a vision of Venezuelan president Hugo Chavez, the ALBA was initially proposed as an alternative to the FTAA. As a first step toward greater integration a trade agreement, known as the People’s Trade Agreement (PTA or TCP in Spanish), has been signed by Bolivia, Venezuela and Cuba. The PTA is aimed not at liberalizing trade or reducing tariffs, but at lowering poverty rates and spurring sustainable development.¹⁶⁶ The agreement “reasserts public control over the economy and attempts to recast the role of the corporation from that of ‘master’ to ‘partner’ in a process of sustainable development.”¹⁶⁷ As one would expect, there is no recourse to international arbitration for investors provided in the agreement; disputes are to be resolved in local courts. On a broader level, the agreement addresses the issue of state capacity through the transfer of resources to the most underdeveloped countries through a Compensatory Fund for Structural Convergence.¹⁶⁸

¹⁶⁴Salgado 2006, at 1066.

¹⁶⁵According to the IISD, cited in Anderson and Grusky 2007, at 25, a number of developing countries are looking carefully at the Model, with a view to incorporating the provisions into BITS.

¹⁶⁶“Bolivia Advocates Alternative Vision for Trade and Integration,” *Upside Down World website*, 11 July 2006, <http://upsidedownworld.org>.

¹⁶⁷*Ibid.*

¹⁶⁸“What is the Bolivarian Alternative for Latin America and the Caribbean?” *Venezuelan Bank of External Commerce*, 5 February 2004, <http://www.venezuelanalysis.com>.

7.4.3 Opting Out?

It has been argued by Werner that:

One of the great fallacies of international relationships is a determinist belief that economic and political circumstances in fact dictate countries' policies, leaving them with no real choice. Quite to the contrary. Countries, like people, always have choices even if some are more difficult and painful than others, and countries dissatisfied with the way investment arbitration functions can *opt out* of it.¹⁶⁹

In the past year, several governments have indicated that they may do just that. A significant degree of unease with the institution of investment protection has arisen in several states, largely a result of the precipitous rise in investor-state disputes. However, in some areas of the world, such as Latin-America, this development also reflects broader political and ideological shifts that have taken place.

Argentina has faced more arbitration cases, and awards against it, than any other country in the world. It is therefore unsurprising that the government has begun to assess the options for avoiding the payment of current awards, and precluding the possibility of future ones.¹⁷⁰ At first the government adopted a legal strategy, canceling the national decree that authorized the submission of disputes to international arbitration and proposing a bill that would give ultimate control of cases to the national courts.¹⁷¹ The country is also now adopting a diplomatic strategy and has announced that it will request that the US, the home-state of a number of investors currently pursuing arbitration, "formally recognize Argentina's right to declare its 2001-2002 financial meltdown an emergency event that permitted it to break contracts otherwise protected by a U.S.-Argentine investment treaty."¹⁷²

In Bolivia, there is an effort to lobby the Constitutional Assembly, which is currently rewriting the country's Constitution, to make it explicit that foreign in-

¹⁶⁹Werner 2003, at 769, emphasis added.

¹⁷⁰As of October 2007, awards against the country totalled US\$750 million and more than 30 claims remained outstanding. See "Argentina Seeks Diplomatic Exit From ICSID Suits," *Dow Jones Newswires*, 12 October 2007.

¹⁷¹Shan 2007, at 643. See also Alfaro 2004.

¹⁷²"Argentina Seeks Diplomatic Exit From ICSID Suits," *Dow Jones Newswires*, 12 October 2007.

vestors must obey national laws and resolve their disputes in domestic courts.¹⁷³ The government has also announced its desire to renegotiate investment treaties with 24 countries, including the US, Brazil, and France.¹⁷⁴ Bolivia is also the first country to formally withdraw from the ICSID Convention.¹⁷⁵ In explaining the withdrawal, the country's trade ambassador Pablo Solon was quoted as stating that international arbitration through the World Bank is expensive and biased against developing countries.¹⁷⁶

The Bolivian President, Evo Morales, has also been encouraging his neighbours, particularly Venezuela and Ecuador, to follow suit. In a statement made at a meeting of the leaders of the three countries, Morales stated: "[We] emphatically reject the legal, media and diplomatic pressure of some multinationals that ... resist sovereign rulings of countries, making threats and initiating suits in international arbitration."¹⁷⁷ Venezuelan President Hugo Chavez has vowed to withdraw from ICSID, as well as from the rest of the World Bank and the IMF, although the move is currently on hold while the finance ministry analyzes the impact on the country's outstanding debt.¹⁷⁸ Ecuador's former President Alfredo Palacio very vocally rejected arbitration in a case with a US oil company.¹⁷⁹ The US froze talks on a free trade agreement with the country as a result¹⁸⁰ and the IMF expressed "concern" about the economic impacts of the move.¹⁸¹ In May 2007, the new President Rafael Correa announced that he would not renew the BIT between Ecuador and the US. The country's Foreign Minister said that the treaty had

¹⁷³"Peru, Columbia Trade Deals Would Lock in More Bad Investment Rules," *Foreign Policy in Focus Report*, 18 December 2006.

¹⁷⁴"Bolivia Plans to Renegotiate Investment Protection Pacts with 24 Countries," *Forbes*, 9 May 2007.

¹⁷⁵According to the *ICSID website*, the World Bank received a written notice of denunciation of the Convention from the Republic of Bolivia on 2 May 2007. In accordance with Art. 71 of the ICSID Convention, the denunciation takes effect six months after the receipt of a party's notice of withdrawal, which in this case was 3 November 2007.

¹⁷⁶"Bolivia Will Withdraw from Dispute Panel, Solon Says," *Bloomberg*, 31 May 2007.

¹⁷⁷"Latin Leftists Mull Quitting World Bank Arbitrator," *Reuters*, 30 April 2007.

¹⁷⁸"World Bank Withdrawal Latest Latin Headache for Big Oil," *MarketWatch*, 30 May 2007.

¹⁷⁹"Ecuador Prez: No Oxy Arbitration," *Prensa Latina*, 9 September 2006; "Ecuador Rejects Arbitration Demand by Occidental," *MarketWatch*, 23 May 2006.

¹⁸⁰"US-Ecuador FTA Talks on Hold After Ecuador Cancels Occidental Contract," *Bridges Weekly Trade Digest*, 17 May 2006.

¹⁸¹"IMF Concerned on Ecuador Cancellation of Occidental Pact," *MarketWatch*, 18 May 2006

caused problems for the country and did not respect national interests.¹⁸² More recently, the country notified ICSID that it would not submit to the jurisdiction of the Centre in any future oil or mining disputes.¹⁸³

Countries in Eastern Europe and Central Asia have also been the target of numerous arbitral claims. In 2006, the Czech Republic announced its intention to terminate or renegotiate its investment agreements with other EU members, as well as some 40 BITs with non-EU countries.¹⁸⁴ In November 2006, a website of the government of Uzbekistan reportedly stated that the government would not recognize rulings made by international arbitral tribunals. The Constitutional Court apparently adopted an amendment to the 1994 law on foreign investment that would invalidate rulings made outside the country and without the consent of the government. The move followed a threat of arbitration from the American mining company Newmont.¹⁸⁵

There are also several examples of states refusing to pay damages awarded to investors, and state courts refusing to enforce awards. As noted in Box 6.2, Indonesia fought against the enforcement of the *Kahara Bodas* award in several courts. Chung notes that Pakistan and Russia have also had such cases, and that their efforts to have awards annulled or set aside “have consequently drawn criticism for undermining international investment as a whole.”¹⁸⁶

However, it is not only developing and transition countries that are increasingly concerned about arbitration. Shan argues that there has been a resurgence of the Calvo doctrine and a weakening of the neoliberal high standard investment protection agenda, particularly in Latin America, but also in other parts of the world, including, surprisingly, in the US Congress.¹⁸⁷ Gagné and Morin also point out that in the negotiations for the recent US-Australia FTA, the Australian government “consistently rejected US demands for an investor-state mechanism,” and

¹⁸²“Ecuador Won’t Renew U.S. Investment Deal,” *Associated Press*, 7 May 2007.

¹⁸³The notification was received on 4 December 2007, <http://icsid.worldbank.org>.

¹⁸⁴“International Investment Arbitration,” *Mondaq*, 9 October 2006.

¹⁸⁵“Uzbekistan Dismisses International Arbitration Courts and Foreign Miners,” *Resource Investor*, 24 November 2006.

¹⁸⁶Chung 2007, at 975.

¹⁸⁷Shan 2007, at 650.

apparently the US conceded to this position without much resistance.¹⁸⁸ Shan argues that the debate has shifted in recent years from “‘strong states’ versus ‘weak states’ (i.e., a ‘North-South divide’), towards ‘state sovereignty’ versus ‘corporate sovereignty’ (i.e., a ‘Private-Public debate’)” and reasons that this shift offers an opportunity for states to agree to a deal that strikes a better balance between investment protection and investment regulation.¹⁸⁹ However, others suggest that the North-South divide remains, and that what is in fact emerging is a double standard; in developed countries, arbitration is still viewed as ‘good’ when it corrects misbehavior by foreign (developing) host states, but as undesirable when their own behaviour is challenged.¹⁹⁰ The absence of an investor-state mechanism in the US-Australia FTA appears to exemplify this double-standard.

Finally, multinational corporations may also be starting to question the value of international arbitration. Peterson argues that Bechtel, which was involved in Bolivia’s ‘Water War’ (see brief discussion of case in Section 7.1.3), “bought themselves at least \$25 million worth of bad publicity.”¹⁹¹ When the suit became known to the public, the company was “bombarded with thousands of emails and letters, facing scores of protests outside their headquarters along with receiving largely negative coverage in the international media.”¹⁹² A UK supermarket chain that pursued arbitration against the impoverished country of Guyana dealt with a similar backlash, and eventually dropped its case as a result.¹⁹³ As civil society becomes more aware of international investment arbitration, the negative implications of bringing claims, particularly for large multinationals, is likely to increase.

¹⁸⁸Gagné and Morin 2006, at 372.

¹⁸⁹Shan 2007, at 664.

¹⁹⁰Alvarez and Park 2003, at 368-9.

¹⁹¹“There are no Winners in Bolivia’s Water War,” *Embassy*, 1 February 2006.

¹⁹²“Bechtel Case Sends Warning to Oil and Gas Multinationals,” *OneWorld UK*, n.d., <http://uk.oneworld.net/article/view/125938/1/5795>.

¹⁹³The Big Food Group sought compensation for a sugar business that was nationalized in 1975. See Hamilton and Rochwerger 2005, at 22-3.

7.5 Implications for Environmental Governance

This section addresses the issue of whether the new developments discussed in this chapter will remedy the problems raised in earlier chapters with respect to environmental governance, particularly in developing countries.

7.5.1 Cosmetic Changes

As noted above, there have been efforts in recent BITs and FTAs to clarify certain substantive provisions that in theory would make it less likely that environmental regulations will be challenged in investor-state arbitration. However, these adjustments are relatively minor and fail to address many of the issues raised in this study.

Firstly, the changes do not make investment arbitration more predictable. While many awards are now published, confidentiality is still pervasive and nothing has been done to make arbitrators more accountable. Furthermore, the clarifications to regulative rules, such as fair and equitable treatment and expropriation, remain open to a significant degree of interpretation. As such, even under re-modelled BITs, threats to arbitrate will remain potent.

Secondly, the new generation of BITs represents only a small subset of existing IIAs, and Europeans have failed to follow the North American lead in adjusting their models.¹⁹⁴ Gantz notes that as a result the American business community now feels that they are at a disadvantage compared to their European competitors.¹⁹⁵ Some arbitrators and authors have also taken exception with the changes introduced in the new generation of IIAs, in particular with the modifications to the fair and equitable treatment standard, arguing that it is an “exercise which, in the large, constitutes a regressive, rather than progressive, development of international law.”¹⁹⁶ If there is a negative reaction to the rather minor substantive changes made in recent BITs and FTAs, a multilateral agreement along the lines of an IISD Model seems very unlikely indeed.

¹⁹⁴Van Harten 2007a, at 164.

¹⁹⁵Gantz 2004, at 764-5.

¹⁹⁶Schwebel 2006, at 7.

Thirdly, tinkering with the existing models may go some way toward reducing the number of disputes, but it will not redress the fundamental imbalance between investor rights and responsibilities. Clémenton, for example, argues that the “elimination of legal compatibility problems alone is not a panacea for making an investment agreement compatible with sustainable development.”¹⁹⁷ Similarly, Shan notes that the new generation of BITs:

demonstrate only small changes...[and] do not alter the fundamental character of these investment treaties as quintessential liberalist instruments, which only protect and ‘empower’ investors without sufficient consideration of the rights of host states and the duties of the investors.”¹⁹⁸

Shan therefore concludes that, “[t]o fully address the problem of the imbalance of rights and obligations between investors and states, a more radical, and even revolutionary solution is needed.”¹⁹⁹

Finally, what is striking about all of the reforms that have been made and about the major proposals that have been suggested for further reform is that they appear to be motivated solely in response to developed country concerns and do little to address the disparities between developed and developing countries that are faced with disputes. This is particularly evident in the EIAs conducted by the US and Canada, which fail to even consider the environmental impacts of American and Canadian investments abroad, making them little more than a public relations exercise. Only the IISD model addresses developing country issues, for example, in proposing the development of a legal assistance centre, an idea that will be revisited in Section 8.2.2.

7.5.2 The Voice of NGOs: Counterhegemonic or Co-Opted?

With the initiatives of NGOs and the subsequent support of some states, there have been changes in the arbitration process to allow for greater transparency and participation by third parties in investor-state disputes. Thus far, the reforms have been largely *ad hoc*, though it seems unlikely that future tribunals will go against

¹⁹⁷ Clémenton 2000, at 215.

¹⁹⁸ Shan 2007, at 656.

¹⁹⁹ *Ibid.*

the general trend in this area. While there is no formal *stare decisis* in investment arbitration, tribunals often refer to past decisions made in other cases, and diverging sharply from the reasoning of the numerous tribunals that have laid out guidelines for the submission of *amicus curiae* briefs would require strong justification. Furthermore, it is evident that there is a fervent desire within the international arbitration community to dispel the popular concerns about the secretive nature of the investment arbitration process.

From a neo-Gramscian perspective, the permitting of NGO participation in investment arbitration could be seen as an attempt at *transformismo*. Since the demise of the MAI in 1998, it has been recognized that NGOs could play an important role in opposing the negotiation of IIAs and pressuring investors to back down from controversial disputes. Furthermore, arbitrators have recognized that the public perceives the arbitration process as secretive and lacking legitimacy. In allowing NGOs to be directly involved, arbitrators may hope to achieve both a silencing of counterhegemonic voices and increased public acceptance of arbitration.

Because submitting an *amicus curiae* brief generally requires familiarity with the complex and technical legal aspects of investment law, only a small group of (generally legally-oriented international) NGOs will be able to participate effectively. Local NGOs will likely participate only with assistance from this group, and it is possible that their voices will be diluted in the process. Furthermore, it is notable that the group of NGOs that most actively participates in arbitration as well as in other relevant fora (e.g., UNCITRAL sessions) are very moderate in their approach. These NGOs take pains to argue that they see foreign investment as essential for the achievement of sustainable development and that they do not, in principle, oppose investor-state dispute settlement.

The question is not whether these NGOs are well-intentioned, as they most certainly are. The question is whether their efforts are actually affecting the outcome of disputes, or are simply helping to sustain the system of arbitration by reducing the public unease which surrounds it. In a discussion of *amicus curiae* briefs at a seminar at the University of Amsterdam, one participant dismissively remarked that “nobody reads them.”²⁰⁰ However, the *Methanex* Tribunal’s referral to the IISD’s submission, albeit brief, suggests that such a conclusion may be

²⁰⁰ Seminar on Investment Law, University of Amsterdam, 12 February 2007.

premature. Further research is required to establish the impact that *amicus curiae* briefs have on the outcome of specific cases and to assess how the participation of third parties affects public perceptions of the legitimacy of investment arbitration (see Section 8.3.3).

7.5.3 Discontent in the Periphery

As Sornarajah points out, “[i]n matters relating to foreign investment, events move in a cyclical fashion. The period of euphoria for foreign investment and liberalization of regimes is usually followed by disenchantment.”²⁰¹ The last two decades of the 20th Century were certainly a euphoric period for foreign investment. However, at least in some parts of the world, disenchantment has now firmly set in. This is most evident in Latin America, where several countries are actively renegotiating contracts with large TNCs, and in some cases even carrying out nationalization programs (e.g., Bolivia, Ecuador, and Venezuela). These countries have had experience with investment arbitration, and have decided that it is an unfair and biased system. However, at the same time many countries in Africa, such as Ghana, are increasing investment protection, for example, by providing commitments to stability (see Section 6.1.2). Thus, it would appear that the hegemony of the transnational historic bloc is uneven. In some parts of the world it retains a fairly firm grip, while in other parts there is evidence of a counterhegemonic movement.

It is worth emphasizing that the disputes that have garnered the most significant attention and the most vocal responses in developing countries have concerned politically salient issues (e.g., over privatization of utilities). When an investor challenges an issue ‘at the heart of a government’s mandate’, the government is less likely to acquiesce than when it challenges an issue of lesser concern. When the rejection of disciplinary neoliberalism is only a response to economically significant and politically sensitive disputes, then the benefits may not spill over into the environmental arena. In fact, a negative experience in arbitration may make a government more prone to settle ‘less important’ conflicts with investors (e.g., see Section 6.1.5). However, if a state more broadly denounces investment

²⁰¹ Sornarajah 2003, at 178.

protection (e.g., non-renewal of BITs, withdrawal from ICSID) then all disputes, including those that relate to environmental issues, will be returned to local courts.

7.6 Summary

This chapter has discussed recent developments (e.g., changes to arbitral rules and model agreements) that have occurred as a response to widespread criticism that investment arbitration is unaccountable and secretive, and to concerns that investment protection may unduly restrain the regulatory power of states.

The most dramatic changes have occurred in the procedures of investment arbitration. Many arbitral awards are now made publicly available, and *amicus curiae* submissions to tribunals are becoming more frequent. Some countries, particularly Canada and the US, have also revised their model BITs and have taken up the practice of conducting EIAs of new investment agreements. However, these changes are largely cosmetic and fail to address the key issues of accountability, predictability, and the capacity of developing countries to handle disputes. Furthermore, the involvement of NGOs in the arbitration process may only serve to lend the institution of investment protection an unmerited air of legitimacy.

More substantial proposals for reform, such as the development of an appellate body or a multilateral investment agreement for sustainable development, were also discussed. These proposals are limited in both scope and viability. In particular, it is unlikely in the current political climate that a multilateral agreement on investment - sustainable or not - could be negotiated.

Finally, it was argued that there are indications that disciplinary neoliberalism is falling out of favour with some peripheral governments, particularly in Latin America. However, the backlash against investment protection will only have implications for environmental governance if it is uniform, and not restricted to disputes over the economic returns from natural resource exploitation.

Conclusions

In this concluding chapter, it is argued that with the advent of the institution of investment protection and the expansion of substantive norms and rules within this institution to cover aspects of environmental protection, elements of environmental governance have been taken over, or *expropriated*, by international arbitral tribunals. It is further argued that the institution of investment protection lacks balance and proportionality, and consequently several proposals to bring symmetry to the institution are made. Reflections on the implications of the study for international relations theory and suggestions for areas of future research are also provided.

8.1 The Expropriation of Environmental Governance

Traditionally, the resolution of environmental conflicts between investors and states has been kept largely within the purview of the political and judicial organs of the state. With the advent of the institution of investment protection, and with the expansion of substantive norms and rules of this institution to cover aspects of environmental protection, elements of environmental governance have arguably been *expropriated* by international arbitral tribunals. While the term expropriation is most commonly associated with the actions of states, its plain meaning

refers to any action to deprive another of a possession (including intangibles such as rights or ideas).¹ To expropriate is to annex, to appropriate, to commandeer, to confiscate, to dispossess, to sequester, to take, or to take over.² Arbitral tribunals have expropriated the authority to determine when an environmental policy or court decision is legitimate. This is not necessarily a role that was freely bestowed upon them; in fact, this study submits that some of the effects of the institution of investment protection were unintended and unanticipated by states.

Some observers suggest that the concerns of environmentalists over investment arbitration are unnecessarily alarmist, and liken them to those of Chicken Little, who declared that the sky was falling when it was not.³ By focusing on individual cases and arguing either that the tribunal made a *good decision* or that the dispute was not *really about the environment*, these observers tend to miss the bigger picture. As Sornarajah has pointed out in the context of the trade regime, the fact that a decision in a given case is supportable from an environmental perspective is immaterial: "The point is whether the dispute was one which should have been disposed of by a trade tribunal when it raised issues which transcended trade matters and implicated interests of concern to the international community at large."⁴ *A fortiori*, this concern also exists with regard to the institution of investment protection where issues of accountability are manifold. Arbitrators in the WTO system are not chosen by the parties to the dispute and cannot act as the legal representation for the parties in other arbitral proceedings. Furthermore, in the trade regime, disputes can only be brought by states who bear an equal risk of having disputes brought against themselves, unlike the one-way system of investment arbitration, which only allows for states to be punished and private actors to be rewarded.

Three claims are made in this section. First, it is argued that the expropriation

¹"Expropriation," *Merriam-Webster Online Dictionary*, <http://www.merriam-webster.com/dictionary>.

²Roget's New Millennium Thesaurus, First Edition, 2007.

³Lilley 2002, at 728; Laird 2001. See also Behrens 2007, at 178, who notes that the "popular fears that host states who have tied their hands by investment protection treaties might be limited to promote, e.g., environmental protection only at the cost of compensating foreign investors, are entirely unjustified."

⁴Sornarajah 2002, at 99.

of environmental governance by arbitral tribunals has led, or will lead, to a loss of democratic accountability in environmental decision-making. Second, it is argued that the institution of investment protection has shifted a significant degree of the risk that is inherent in foreign investment from investors to host states and has created considerable uncertainty for regulators. Finally, it is argued that the direct disciplining of states in arbitration, and the indirect influence that arbitration has on regulators, will lead to a decrease in the amount, and/or the effectiveness, of environmental regulation produced in developing countries. It is concluded that there is insufficient evidence that states have been compensated for these losses by increased flows of foreign investment that will support sustainable development.

8.1.1 Less Democratic Accountability

The expansion of the institution of investment protection to the point where it may interfere with public policy development has not only taken environmental regulators unawares, it has also shocked the general public, who expect their government to be accountable to them rather than to foreign corporations and enigmatic tribunals. Traditionally, in international law and international relations states are considered the loci of power and authority. The protection of foreign investment through international, regional, and bilateral agreements and through state contracts shifts some of this power and authority to arbitral tribunals. That arbitrators are resolving disputes of great public importance is not novel *per se*; they have had a long and significant role in the resolution of both inter-firm (commercial) and inter-state disputes. However, what is novel is the ease by which private actors, vested with international legal rights, but not responsibilities, are able to directly initiate arbitration against sovereign states. Of further significance is the breadth of the investment arbitrators' jurisdiction and the elevation of dispute resolution to a governance system aimed at 'regulating the regulators'.⁵

It is acceptable in democratic countries for domestic courts to check the power of the legislature, because the judiciary is considered reasonably free from political influence.⁶ On the other hand, as a governance system, investment arbitration is fundamentally undemocratic and its neutrality is questionable. The procedural

⁵Head 2007, at 515.

⁶Van Harten 2007a, at 168.

rules and norms of investment protection were established to deal with commercial disputes where confidentiality was considered paramount, and consistency irrelevant. Such a system is inappropriate when states are involved in disputes and especially when sensitive issues of public policy, such as environmental regulation, are at stake. How can a system that is itself experiencing a 'legitimacy crisis' possibly be suited to making decisions on the legitimacy of democratically elected governments and domestic judicial systems? Supporters may argue that the system of investment arbitration is, despite having existed for decades, still in its infancy (or at most early childhood) given that it has only been frequently put to use in the last ten to fifteen years. However, while some procedural flaws may be eliminated with time, and while the reasoning of tribunals may become more nuanced with the increased scrutiny that awards are likely to receive, a 'wait and see' attitude is cold comfort for states faced with the prospect of (numerous) economically significant awards being decided against them.

While there has been considerable focus on the lack of transparency and participation in the arbitration process in this study, it must also be emphasized that these elements are absent or limited in other areas as well. As noted, state contracts are frequently negotiated and signed without the involvement of parliament or the disclosure of the agreement to the public. The typical justification given by governments for confidentiality of contracts is that disclosure would negatively affect their bargaining power in future contract negotiations. However, as a guide produced by the IMF notes, the terms of a contract are likely to be widely known within the industry soon after signing, and:

Little by way of strategic advantage thus seems to be lost through publication of contracts. Indeed, it could be argued that the obligation to publish contracts should in fact strengthen the hand of the government in negotiations, since the obligation to disclose the outcome to the legislature and the general public increases pressure on the government to negotiate a good deal.⁷

In fact, in some sectors, such as petroleum and gas, contracts are available through expensive subscription services.⁸ This type of system ensures that companies and

⁷IMF 2007, at 17.

⁸See, e.g., <http://www.barrowscompany.com>.

elite law firms will have access to contracts, while civil society and academic researchers will not. As a result, there is reduced accountability of both governments and foreign investors. As one NGO report points out:

Without public scrutiny of foreign investment contracts, it is impossible for citizens to judge whether or not their elected governments are acting in their best interests and effectively pursuing or meeting public policy goals. It is also impossible for them properly to hold their governments to account for consequences of foreign direct investment.⁹

In addition to being negotiated in fundamentally undemocratic ways, IIAs and state contracts also bind governments for long periods of time. Hence, the ministries that sign these agreements are ‘locking-in’ other ministries and future governments to the institution of investment protection. Governments may therefore be legitimately constrained in their responses to democratic demands. However, commitments to investment protection also give governments a way to avoid domestic political backlash to unpopular decisions. The ability of governments to utilize commitments to investment protection as political cover, which is enhanced when the details of commitments are not publicly disclosed from the outset, arguably reduces the democratic accountability of government decisions.

8.1.2 Less Certainty for Regulators

While it is certainly not possible to predict with perfect accuracy the outcome of dispute resolution in any context – if it were, we would not need judges – uncertainty in the system of investment arbitration is particularly pronounced.

The regulative rules and norms of investment protection are ambiguous, and vary in their specific wording from treaty to treaty. When arbitral tribunals attempt to throw light upon the meaning of these rules and norms, their interpretations are controversial and inconsistent. Transparency is increasing, but confidentiality is still ubiquitous, making it more difficult for states to evaluate how disputes have been treated in arbitration. Furthermore, states may not even be aware when an investor is actually protected by an IIA, as opposed to when a threat of arbitration

⁹ Ayine *et al.* 2005, at 3.

is a bluff. While state contracts are made directly with a specific investor, regarding a specific project, IIAs cover a vast number of unknown potential investors. With mergers, frequent changes in ownership, and TNCs able to relocate to take advantage of 'flags of convenience', states may be understandably uncertain about the validity of investor claims.

As a result of decreased certainty, a substantial portion of the risk that is associated with investing abroad, particularly in developing countries, has been shifted to regulators. Of course, investors cannot be certain that they will succeed in arbitration or that, if they are successful, the level of compensation will be fair and promptly paid. Arbitration is also risky for investors who wish to continue operating in a specific country, or region: just as governments can acquire a bad reputation with investors, so too can investors acquire a bad reputation with governments. However, clearly the risks of investing have been diminished. It is, after all, the main purpose of the institution of investment protection to promote investment flows by reducing political risk. Risks for foreign investors are also minimized by investment insurance and other mechanisms. On the other hand, states that already risk the loss of resources (with often unfair returns), and serious environmental harm, now additionally risk being sued in international arbitration. When the outcome of arbitration is uncertain, states that are faced with a threat of arbitration are more likely to settle, often at the expense of public policy.

8.1.3 Less (Effective) Environmental Regulation

Environmental regulators appear to be particularly susceptible to conflicts with investors because environmental standards do, and must, constantly change and evolve, and because the implementation of environmental policy often involves significant costs. The institution of investment protection does not categorically reject the right of states to regulate investment for the protection of the environment, and in fact, many IIAs explicitly confirm this right. However, arbitral tribunals have taken on the role of deciding *how* and *when* a government should enforce this right. In the view of many tribunals, governments should only adopt policies that are *least inconsistent* with investment protection, have been developed through a process that is *predictable* and *transparent*, when a substantial amount of *scientific evidence* supports action. These criteria do not hold universal

acceptance amongst arbitrators, but governments that do not follow this formula risk being disciplined in arbitration.

Additionally, investment protection, and stabilization clauses in particular may limit the number of tools in the ‘policy toolbox’. For example, stability of the fiscal regime might preclude the use of a market mechanism to tackle environmental pollution. If investment protection limits the range of instruments available to regulators, then this may in turn result in a reduction of the effectiveness or efficiency of the policies produced.

Finally, in addition to directly castigating states, arbitrators also *influence* regulators and judges. Just as any good judicial system will *prevent* as well as *punish* crime, the system of investment arbitration dissuades regulatory or judicial misconduct by states. The problem is that it may also deter policy development and court proceedings that are in the interests of the public good. Environmental ministries, agencies, and even domestic courts may be voluntarily giving up some degree of responsibility for the governance of the environment out of fear that their policies and decisions will be challenged in arbitration (regulatory and judicial chill). Those wishing to maintain the status quo in environmental policy, whether it be investors or non-environmental government agencies, can exploit these fears to their advantage.

8.1.4 Compensation?

One could nevertheless conclude that the transfer of some authority to international tribunals is a “small price, if any price at all, to pay for the numerous benefits of international trade and investment.”¹⁰ But where is the proof of the benefits of investment protection? Establishing a causal connection between the conclusion of IIAs and increased foreign investment flows is riddled with difficulty and remains contested in the literature (see Section 1.1.1). Furthermore, any gains made by developing countries in attracting investment through IIAs will be largely at the expense of other developing countries, because the system is based on competition, and thus overall welfare will not improve even if specific flows increase.¹¹

¹⁰Laird 2001, at 229.

¹¹Guzman 1998, at 688.

Then there is the question of the actual benefit to the host state of increased inflows of foreign investment if they do materialize. In particular, there is the issue of the value of foreign investment in the form that is promoted in IIAs and state contracts, given the fact that these agreements seem to emphasize the encouragement of foreign investment as if it were *an end in itself*, rather than a means to achieving sustainable development.¹² It is suggested here that it cannot be assumed that foreign investment will generally promote sustainable development, particularly as long as the fundamentally asymmetrical institution of investment protection remains in place.

8.2 Bringing Symmetry to the Institution of Investment Protection

In this section, it is argued that the institution of investment protection produces or exacerbates power differences between certain individuals and groups in both the global context and within a state.¹³ Following this, recommendations that would bring a greater degree of symmetry to the institution are made.

8.2.1 The Asymmetry of Investment Protection

The asymmetry of investment protection is most evident in the comparison of the benefits and consequences of the institution for:

- Foreign investors and states;
- Foreign investors and ‘everyone else’;
- Arbitral tribunals and governments;
- National and lower levels of government within a state;
- Economic and environmental ministries within a state; and
- Developed and developing countries.

¹²García-Bolívar 2005, at 754.

¹³For an alternative view of the asymmetries of investment arbitration, see Wälde 2007, at 54-67.

Foreign Investors and States

The first asymmetry produced, between foreign investors and states, concerns an imbalance between rights and obligations. In this study, the numerous IIAs, state contracts, and the system of investment arbitration have been classified as composing the institution of *investment protection* because this title conveys the fundamental one-sidedness of *protecting* investors but not *obliging* them to take on any responsibilities, and conversely *obliging* states to behave in a given manner, but not *protecting* them from harm that an investor may cause. This asymmetry is often justified as a means to redress the existing imbalance between the power of states and the power of investors. In this view, the state as ‘leviathan’ can easily crush the unsuspecting foreign investor. However, in reality the picture is quite dramatically different; over one third of the world’s 100 largest economies are corporations, not states. Developing countries are especially vulnerable because they are desperate to attract investors in order to finance development.

Wälde argues that large corporations rarely use investment arbitration because they don’t need to (i.e. they have leverage to negotiate and expertise in the management of risks) and they don’t want to (i.e. because it may poison their relations with host states).¹⁴ However, he does admit that arbitration can be useful as a “bargaining card” for multinationals. The fact that large multinationals may only use investment protection as a bargaining card does not eliminate this asymmetry. Indeed, the cases discussed in this study have shown that the *threat* of arbitration can be as, or more, obstructive to policy development than its *actual use*.

As a result of the incongruence between rights and obligations, investors do not face a strong risk of counterclaims being brought against them and are, therefore, more likely to abuse the arbitration system and make spurious allegations against states. Arbitration is expensive, but just initiating a claim, or threatening to do so, costs very little.

Foreign Investors and Everyone Else

The second fundamental asymmetry that is brought about by investment protection occurs between foreign investors and everyone else, including domestic in-

¹⁴Wälde 2007, at 62.

vestors. Domestic investors are not offered the same level of protection as foreign investors who are entitled to fair and equitable and most favoured nation treatment in addition to national treatment. Domestic investors are also not offered stability agreements, which arguably could give foreign investors a significant competitive advantage. Finally, domestic investors are not provided with access to international arbitration in the event of a conflict. Thus for all the emphasis on non-discrimination, the institution of investment protection clearly discriminates against domestic investors in favour of foreign ones. Again, the arguments to justify this, that domestic investors are familiar with the local court system and will therefore fare better in it, or that domestic investors are more likely to curry favour with their own government, and in any case have the right to vote in general elections, are not particularly convincing. Xenophobia may certainly work against foreign corporations, but domestic companies also face their own challenges and are generally smaller and less powerful than TNCs. Furthermore, domestic companies do not have the option of *exit* and therefore must rely solely on the strategy of *voice*.

However, it is not only domestic investors who are disenfranchised in international law. Even more significantly, indigenous peoples, local communities and other individuals who suffer human rights abuses (including the denial of the right to a healthy environment) at the hands of either a state or a corporation, lack the necessary means to redress the wrongs that are committed against them. Human rights treaties are nowhere near as prevalent as IIAs, are much more difficult for individuals to access, require the exhaustion of local remedies, and do not hold non-state actors accountable for violations.¹⁵ While it is not suggested here that the institution of investment protection should be designed to redress all wrongs done to all peoples, greater balance – achieved either through a strengthening of the rights of others or a reduction of the rights of investors – would contribute to the maintenance of a stable international order. The current asymmetry leaves open the question of why one class of individuals are singled out for preferential treatment. Furthermore, if the institution of investment protection results in regulatory or judicial chill, or decreases the efficiency and effectiveness of environmental regulation, then it is not only that foreign investors are given more

¹⁵ Kriebaum 2007, at 186; Sornarajah 1997, at 134.

favourable treatment, it is that this treatment is given *at the expense* of the well-being of others.

Arbitral Tribunals and Governments

A third asymmetry exists in what is expected of arbitral tribunals and of governments in the institution of investment protection. It has frequently been argued that the obligations of states under the institution of investment protection are the “ingredients of good governance.”¹⁶ Such an analysis is appealing. Who, after all, can argue with the need for greater accountability and transparency in governance? However, a more critical evaluation reveals that the ingredients of good governance are *selectively applied* in the institution of investment protection. In particular, it does not appear that the principles of transparency, accountability and participation must apply in contexts that would be disadvantageous to investors, such as in the negotiation of state contracts or, crucially, in the resolution of disputes.

As Van Harten points out:

Governments are often required to make difficult and controversial decisions when exercising public authority and their policy choices may in some cases appear to misapprehend facts, apply misguided theories, emphasize wrong-headed priorities, or create more problems than they solve. This is in many ways inherent to the dilemmas of governing.¹⁷

It is also the case that, as governors themselves, arbitrators make mistakes, interpret the rules and norms of investment protection in controversial ways, and apply theories about international law that are not universally accepted. However, while states are to be held accountable to tribunals, it would appear that arbitrators are accountable to no one. While states must govern in a transparent and predictable manner, tribunals may operate behind closed doors and do not have to ensure that their decisions are consistent with those made in substantively similar cases.

¹⁶Dolzer 2005, at 972. See also Newcombe 2007a, at 393; Schill 2007, at 285; Gutbrod and Hindelang 2006, at 82; ILA 2006, at 16; Wälde 2004, at 475.

¹⁷Van Harten 2007a, at 89.

Levels and Sectors of Government within a State

The fourth and fifth asymmetries that are produced, or perhaps more accurately *exacerbated*, by the institution of investment protection occur between different levels and sectors of governance within a state. The national government representatives that negotiate state contracts and IIAs are unlikely to be knowledgeable on environmental issues or sympathetic to the concerns of environmental agencies and ministries.¹⁸ Most environmental regulators will be unaware of the implications of these agreements until a conflict arises. The already complex balance of power that exists between various levels and sectors of governance is upset by the the investment arbitration system that targets one level (national) and reinforces the power of one sector (economic/industrial).

While state, provincial and municipal levels of government are often accorded a significant degree of competence over environmental matters, and although decentralization is a process occurring in many developing countries, only national governments have standing in international law. This creates difficulties for both upper and lower levels of government. Although they are uninvolved in the negotiations of state contracts and IIAs, unaware of the policy implications of these agreements, and potentially unable to participate in arbitration, lower levels of government may be pushed to reverse policies or to pay compensation to foreign investors who claim breach of treaty or contract. Despite the potential negative implications for multilevel governance, it must also be acknowledged that it is understandable that national governments are concerned about being held accountable in international arbitration for the actions of lower levels of government over which they may have little control.

In addition to creating tension between levels of governance, conflicts with investors may also result in ministries and agencies being pitted against one another. A savvy foreign investor will exploit such divisions to his advantage. The existence of the institution of investment protection gives the investor and his government supporters a distinct advantage over the opposition; even if environmental regulators are well-advised on the nuances of investment law, they are provided with little certainty that their policies will stand up under the scrutiny of an arbitral tribunal. Without strong and enforceable international agreements on the

¹⁸Tabb 2004, at 27.

environment or on the conduct of TNCs, environmental regulators are left with no comparable clout to bolster their position and must rely solely on public pressure and NGOs for support.

Developed and Developing Countries

The final, and perhaps most significant asymmetry relates to the implications of the institution of investment protection for developed and for developing countries. While arguably such asymmetry will exist in any international arrangement involving developed and developing countries, it is much more conspicuous in IIAs. This is particularly true for those IIAs that are negotiated bilaterally, leaving developing countries in the weakest possible bargaining position.¹⁹

Developing countries are far more likely to face conflicts with investors over environmental issues than are developed countries for several reasons. First, environmental policy is more likely to *change* in developing countries. Continuous change is an integral part of environmental governance in any country, but it is commonly accepted that developing countries, in general, have a lower base-line of environmental regulation. As a result, there is a greater likelihood of rapid, and possibly radical, regulatory change in these countries, as awareness increases and as governments are asked by the international community to 'catch up' with developed country standards. At the same time, it has been emphasized by experts that change in policy, rather than its absolute level, is the most significant problem for investors. Thus, change in policy is likely to lead to conflict. A statement by a Chilean trade official exemplifies this predicament:

Chile is a country where probably there will be quite a lot more regulatory changes in the future. There is still a lot of work to be done in that area, and to expose ourselves to the kind of demands by U.S. investors like what has happened with NAFTA, where the investors say regulatory changes have been tantamount to indirect expropriation and have demanded huge compensation involving many millions of dollars, well that would be very difficult for Chile.²⁰

¹⁹ Ekwueme 2006, at 170-1.

²⁰ Qtd. in Been and Beauvais 2003, at 126.

Secondly, there is less policy *coherence* in developing countries, meaning that effective communication between different ministries and different levels of government is often lacking. Policy incoherence may certainly also exist in developed countries, but it is commonly acknowledged that government agencies in developing countries are especially underfunded and overstretched, particularly in the environmental sector. Developing countries that are undergoing a process of decentralization are also likely to experience a number of glitches (governance gaps and overlaps) before the process of multilevel governance starts running smoothly. Policy incoherence inevitably leads to conflict. If an investor's 'legitimate expectations' are based on the assurances of one governing body, which has not consulted with other relevant bodies, then these expectations are unlikely to be met.

Thirdly, there is a higher instance of *corruption* in developing countries. Corruption can result in investors receiving very favourable treatment, particularly under state contracts that are negotiated in the absence of transparency.²¹ The country is subsequently locked-in to this standard of treatment by the institution of investment protection, even if a new (less corrupt) government is elected. Corruption, or even the perception of corruption, can also inflame public hostility to investment projects, which may lead to public protests and, subsequently, conflicts between the investor and the host state.

Finally, the *courts* in developing countries are less respected and trusted by the international community. This is arguably the primary justification for the development of international investment arbitration in the first place. As a result, claims brought against foreign investors in domestic courts, for environmental liability for example, are more likely to be challenged in investment arbitration for a lack of due process or denial of justice.

In addition to the fact that developing countries are more likely to be confronted with conflicts related to the environment than are developed countries, it is also argued here that it is more likely that these conflicts will be resolved in investment arbitration, or that their resolution will be influenced by the threat of arbitration. Because they are more desperate for capital, developing countries make more *commitments* to investment protection, in the hopes that it will foster increased FDI flows. Furthermore, these commitments are categorical, while de-

²¹ Ayine *et al.* 2005, at 3, suggest that a "[l]ack of transparency is a breeding ground for corruption."

veloped country commitments are illusory so long as IIAs are only negotiated on the basis of asymmetric flows of FDI. In this respect, the NAFTA is an anomaly. Developing countries are more likely to be influenced by the threat of arbitration because of concerns about the *cost* of arbitration, both in terms of actual financial costs of lawyer and arbitrator fees and in terms of the cost to their reputation as an investor-friendly host, and because of their lower technical *capacity* to deal with arbitration. For these reasons, developing countries are also more likely to lose the cases that are brought against them in arbitration.

The discrepancy in the obligations of developed and developing countries under IIAs has been justified by supporters of investment protection by the fact that, in theory, developed countries already possess a ‘civilized’ system of law and therefore do not have to be held accountable under international law. Aside from the extreme arrogance of this claim and the lack of deference that it indicates for the special situation of developing countries, it also appears to be disproved by the fact that foreign investors appear eager to pursue arbitration claims against ‘civilized’ countries such as Canada and the US, in the rare instances when they *have the opportunity* to do so.

8.2.2 Recommendations

The reforms that have already been adopted or have been proposed by other scholars were analyzed in Chapter 7. In this section, some further recommendations are made, with a particular view to the asymmetry of investment protection as outlined above.

With regard to the content of IIAs and state contracts, it is recommended that states:

- Omit access to investor-state arbitration;
- Omit reference to the international minimum standard/fair and equitable treatment;
- Omit stabilization clauses; and
- Add reference to principles of environmental law.

Additionally, states should *increase transparency and participation* in contract and treaty negotiation. Developing countries should also make efforts to

Table 8.1: Why the Implications of Investment Protection are More Significant for Developing Countries

	<i>Meaning</i>	<i>Consequence</i>
<i>Change</i>	Lower baseline of environmental standards and significant domestic and international pressure on governments to raise them.	Higher likelihood of investor-state conflicts emerging.
<i>Coherence</i>	Overlapping responsibilities and poor communication between sectors and levels of government.	Higher likelihood of investor-state conflicts emerging.
<i>Corruption</i>	Investors given favourable deals by corrupt officials (investment protection locks in favourable conditions).	Higher likelihood of investor-state conflicts emerging.
<i>Courts</i>	Domestic judicial process is perceived as less neutral/independent.	Higher likelihood of investor-state conflicts emerging.
<i>Commitments</i>	Governments sign more IIAs (commitments are meaningful) and make unilateral commitments to investment protection.	Higher likelihood that, when conflicts emerge, arbitration (or credible threat of arbitration) can be employed by an investor.
<i>Cost</i>	Financial and reputational cost of arbitration is higher.	Higher likelihood that a threat of arbitration will affect the outcome of an investor-state conflict.
<i>Capacity</i>	Lack of technical resources and expertise to respond to arbitration effectively.	Higher likelihood that a threat of arbitration will affect the outcome of an investor-state conflict, and that investor claims will succeed in arbitration.

cooperate to a greater extent on investment issues to avoid the bidding wars that competition for investment can create. Finally, international organizations, research institutions, lawyers, NGOs, and states should collaborate to create a *legal assistance centre* for developing countries. Each of these recommendations is briefly outlined below.

Omit Access to Investor-State Arbitration

Absent the creation of an entirely new mechanism of investor-state dispute settlement, such as the investment court proposed by Van Harten and mentioned in Section 7.4.1, it would seem that the most sensible option for governments is to restrict access to arbitration to states only, and provide investors recourse to only domestic remedies. Such a statement will undoubtedly be met with great consternation from the majority of writers in the investment arbitration field. However, if it is acceptable for Australia to refuse investor-state arbitration with the US, then it should be equally acceptable for any developing country to do so. In response, a supporter of investment protection could argue that the courts in Australia are equipped to deal fairly and justly with investor-state disputes, while the courts of many developing countries are not. Even if one accepts this claim, it does not justify circumventing domestic courts with a completely inadequate international system. If anything it suggests that countries concerned about how their investors will be treated in foreign courts should, for example, invest in targeted aid to support legal education in developing countries.

Omit Reference to the Minimum Standard/Fair and Equitable Treatment

In addition to (or in lieu of) avoiding the current system of investment arbitration, reference to the international minimum standard/fair and equitable treatment should not be included in new IIAs. The standard is simply too broad and has been interpreted too expansively by tribunals. Providing an interpretation of the standard, as done by the NAFTA Parties, may not eliminate this problem. Equating the standard with customary international law only opens the door to debate on what constitutes custom. Given the widespread support, evidenced in the ILA discussions, for the idea that fair and equitable treatment is essentially equivalent

to a requirement for good governance, the potential for future claimants to rely on this standard is significant.²² Furthermore, it does not seem unreasonable to recommend avoidance of the standard, given that not all IIAs presently include it.

Omit Stabilization Clauses

State contracts, if they are to be employed by states, should not include stabilization clauses or be stabilized through enactment into law. Given the fact that in many developing countries environmental regulation of foreign investment is minimal to begin with, agreeing to general or specific commitments to stability of the environmental regulatory framework could lock a country into deteriorating environmental conditions. If a developing country is determined to adopt stability commitments, then it should, at the very least, frame the clause or agreement in such a way as to favour renegotiation rather than arbitration. Furthermore, if investors are really only concerned with the predictability of legislation, and not with the strictness of it, then they could conceivably agree to stabilize their environmental commitments at a higher level (e.g., home country standards) from the beginning of the contract.

Add Reference to Principles of Environmental Law

When drafting IIAs and state contracts, governments should ensure that it is explicitly stated that the purpose of these agreements is to promote and protect investment *that contributes to sustainable development*. However, considering the amorphous nature of this concept, governments should also incorporate in the text of IIAs the most important and relevant principles of international environmental law. It is essential that the precautionary principle be included in IIAs to ensure that governments will not be punished for being ‘first movers’ on an issue when scientific evidence remains inconclusive. Additionally, the adoption of the principle of common but differentiated responsibilities would support the acceptance that developing countries, particularly when they face extreme circumstances (e.g., debt, financial crises), should be given greater leniency. This is not to say that poor countries should never have to compensate investors, but it

²²ILA 2006.

does signify that factors, such as the country's ability to pay, should be taken into consideration. The common but differentiated responsibilities principle, coupled with the polluter pays principle, is essentially the modern day equivalent of the appropriate compensation doctrine. However, given the broad acceptance of these principles by the international community, there is little justification not to include them in IIAs. In fact, a majority of the delegates that negotiated the Draft MAI favoured explicit mention of the polluter pays and precautionary principles in the preamble of that agreement.²³

Increase Transparency and Participation in Contract and Treaty Negotiation

The way in which state contracts and IIAs are negotiated must also be reformed. It is ironic that transparency (on the part of governments) is touted as a key ingredient of a friendly investment climate, and yet state contracts with investors are frequently confidential documents, and negotiations remain a remarkably secretive affair in most countries. While IIAs are public documents, that does not mean that negotiations are carried out transparently or with the participation of environmental ministries and agencies and lower levels of government.

Transparency and participation in the negotiation of all state contracts and IIAs would decrease corruption and policy incoherence, lessening the chance that investor-state conflicts will arise. In recent years, there have been several international efforts aimed at increasing transparency in the natural resources sector (e.g., Publish What You Pay and the Extractive Industries Transparency Initiative). However, the focus has primarily been on the issue of royalties and the management of public revenues derived from the sector, rather than on the overall transparency of contractual and international legal commitments made by governments.²⁴

²³The Multilateral Agreement on Investment Draft Consolidated Text, DAF/MAI(98)7/REV1, 22 April 1998, at 8, <http://www.oecd.org>.

²⁴For information on Publish What You Pay, see www.publishwhatyoupay.org, and on the Extractive Industries Transparency Initiative, see www.eitransparency.org

Promote Cooperation, Rather than Competition

The problem with recommending that developing countries not provide investors with access to arbitration, and that they eliminate the fair and equitable treatment standard and stabilization clauses is, of course, that they do not have significant bargaining power in negotiations with other states or directly with investors. Even absent any proof of IIAs fostering greater flows of FDI, it is still the case that the conclusion of an IIA may be tied to other benefits for the host country, such as preferential trade access or economic aid. In such situations, it is understandable that developing countries will succumb to pressure to accept the terms offered in standard developed country models. The bilateral nature of the majority of IIAs exacerbates this problem. When developing countries cooperate, such as in the WTO context, they are often successful. However, as long as the prevailing ideological paradigm is that states must compete for foreign investment, developing countries will be trapped in a prisoner's dilemma.²⁵ In this regard, Beck's proposal that states pursue policies of cooperation, aiming to establish comparable conditions of production in different host countries and establishing 'host cartels' is intriguing.²⁶ Beck argues that in addition to benefiting from an exchange of information, host countries will limit the risk of being played off against one another in a competition for FDI.²⁷

Greater collaboration among developing countries has also been called for in the area of trade, where developing countries have been relatively successful in multilateral fora, but not coordinated in their response to an increasing number of bilateral trade agreements. Braithwaite suggests that a more organized and structured response, based on a visionary agenda that will attract support from within developed states (e.g. NGOs), is the best, if not only, option for developing countries to resist the divide-and-conquer strategy of the US and Europe.²⁸ Drahos further expands on this idea, arguing that greater collaboration should, to start

²⁵ In a competitive environment, it is optimal for developing countries to collectively reject strong rules and norms of investment protection, but to agree to them on a bilateral basis. See Guzman 1998.

²⁶ Beck 2005, at 202.

²⁷ *Ibid.*

²⁸ Braithwaite 2004, at 313-4.

off with, be aimed at developing high quality analytical resources and strategy.²⁹ Drahos suggests that collaboration should cover multiple issues, eliminating the current reliance on *ad hoc* veto coalitions that emerge in different fora. This type of long-term strategy resembles Gramsci's 'war of position'.

Another way to achieve some degree of harmonization and to reduce competition among host states is through an international binding code of corporate conduct. However, given the apparent reluctance of developed countries to engage in negotiations for such a code, it would appear that developing countries have a greater chance of success if they focus on collaboration with other developing countries.

Create a Legal Assistance Centre

All of the above recommendations relate generally to the future. It is clear that given the large number of existing disputes and agreements that will not expire for a decade or more, action is also needed to deal with the immediate situation. In this regard, this study echoes Gottwald's call for a legal assistance centre.³⁰ Wälde also advocates a legal aid mechanism, suggesting the WTO Legal Advisory Centre as a model, and the IISD included a provision on a legal assistance centre in its Model Investment Agreement (see Section 7.4.2).³¹ Such a centre could offer states access to relevant documents, training courses for both the negotiation of agreements and the settlement of disputes, specific legal advice on cases, and even representation in arbitration.³²

Efforts to remedy issues of technical and financial capacity of developing countries have thus far been limited. In 2005, UNCTAD launched a pilot course with "a view to equip especially developing country governments with the necessary capacity to manage investor-to-State disputes and to be able to mobilize the necessary expertise to assist in the proper conduct of such procedures."³³ The IC-

²⁹Drahos 2003, at 2.

³⁰Gottwald 2007.

³¹Wälde 2007, at 67. Legal assistance centres have also been advocated in other areas, e.g., climate change, but the focus is generally only on preparing countries for negotiations. See Gupta 1997.

³²Gottwald 2007, at 269.

³³Joubin-Bret 2005, at 2.

SID Secretariat has also cooperated with UNCTAD and organizations such as the International Development Law Organization in training programs for officials of developing countries.³⁴ The South Centre has recommended that the ICSID Secretariat should additionally consider the establishment of a fund for developing countries that could contribute to facility costs.³⁵

It is argued here that a new centre, independent of UNCTAD or any arbitration supervisory body, should be established. Such a centre could be maintained by government contributions, or alternatively through a network of NGOs, law offices and academic institutions. Individuals already contribute significantly to fostering information exchange through websites devoted to publishing tribunal awards and decisions,³⁶ and the e-newsletter *Investment Treaty News* has substantially increased public awareness about disputes.³⁷ Furthermore, many NGOs, particularly those involved in submitting *amicus curiae* briefs, have acquired substantial legal knowledge in the area. A new legal assistance centre should not reinvent the wheel; it should instead build on all of these commendable efforts.

8.3 Theoretical Reflections and Areas for Future Research

This section addresses what has been learned in the course of this study about the nature of conflicts between investors and states. It furthermore reflects on the value of a neo-Gramscian framework of inquiry, and identifies key areas that require further research.

8.3.1 State Strategies to Deal with Conflicts with Investors

In Chapter 1, it was argued that investors have three strategies that they can employ when faced with a conflict with a host state regarding an environmental policy or

³⁴ICSID 2004, at 14.

³⁵South Centre 2005, at 14.

³⁶The *Investment Claims website* edited by Todd J. Grierson-Weiler and Ian A. Laird, <http://www.investmentclaims.com>, and the *Investment Treaty Arbitration* website edited by Andrew Newcome, <http://www.ita.uvic.ca>, are worthy of particular note.

³⁷The newsletter is edited by Luke Eric Peterson and supported by the IISD, <http://www.iisd.org/investment/itn/>.

Table 8.2: Bringing Symmetry to the System

	<i>Asymmetry</i>	<i>Recommendation</i>
<i>Foreign Investors v. States</i>	Obligations v. Rights	Host state cartels; code of conduct.
<i>Foreign Investors v. Everyone Else</i>	Enforceable Rights v. No/Less Enforceable Rights	No investor-state arbitration; no stability clauses; code of conduct.
<i>Arbitral Tribunals v. Governments</i>	Unaccountable/Non-Transparent v. Good Governance	No fair and equitable treatment.
<i>National v. Lower Levels of Government</i>	Liable under International Law v. Not Liable under International Law	Transparency and participation in IIA and contract negotiations.
<i>Economic/Industrial v. Environmental Ministries/Agencies</i>	Hard International Law v. Soft International Law	Code of conduct; adoption of precautionary principle; transparency and participation in IIA and contract negotiations.
<i>Developed v. Developing Countries</i>	Implications of Investment Protection (see table 8.1).	Legal assistance centre; adoption of principle of common but differentiated responsibilities.

decision of a court: accept the policy or decision and associated costs; exit the jurisdiction; or exercise voice. Considerable focus has been given in academic literature to the fact that “*states have roots while investors have wings*.”³⁸ While this is certainly an important observation, it is nevertheless the case that when investors have a choice between *fight* or *flight*, they may often opt for the former. This is particularly the case in capital intensive investments with large sunk costs, such as mining and oil operations, and in situations in which investors have the institution of investment protection to support their voice.

The cases in this study have illustrated that a threat to arbitrate can be an effective tool for an investor who has adopted a strategy of voice. However, they also indicate that states do not uniformly capitulate to investor demands when faced with the prospect of arbitration. While states faced with a conflict with an investor clearly do not have the option of exit, they can exercise their voice through third party dispute settlement (TDR) (arbitration and litigation), negotiation, and indirect measures (naming and shaming), just as investors do.

In terms of TDR, a state faced with a threat can opt to agree to arbitration and proceed to challenge the jurisdiction of the tribunal and the merits of the investor’s claims (the strategy adopted by each state involved in the first-order cases presented in Chapter 5). Alternatively, states can utilize foreign or domestic courts to attempt to block arbitration proceedings, as Ecuador did in the ChevronTexaco case (Section 6.2.2). If an arbitration does not proceed favourably, a state may opt to discontinue the proceedings in favour of settlement, as Canada did in the *Ethyl* case (Section 5.1.1). Finally, if an unfavourable award is delivered by a tribunal, the state can challenge it in the courts in the seat of arbitration, as occurred in *Metalclad*, and *S.D. Myers* (Sections 5.2.2 and 5.2.4), or commence annulment proceedings (if it is an ICSID award). The state may also endeavour to block enforcement of the award in domestic and foreign courts.

If a state chooses not to proceed with arbitration and instead opts to negotiate with the aggrieved investor, it may end up paying the investor compensation, offering alternatives (e.g., proposing a different site for a landfill), or retracting the offending policy or decision. In the latter strategy, the state may roll-back policy completely, or make an exception, for example, to exclude application of a law

³⁸Beck 2005, at 72.

to existing investments. The government may attempt to offset the negative environmental effects of such a strategy by imposing certain conditions on investors who are exempted from the application of a law, for example, as occurred in the Indonesian and Ghanaian forest cases (Sections 6.1.1 and 6.1.2).

Finally, just as investors can employ naming and shaming tactics against a state, so too can states garner support from NGOs and the international community. As mentioned in Section 7.4.3, investors that have initiated or threatened to initiate arbitration proceedings, especially against poor countries, have often received bad press and have even been the subject of protests and NGO campaigns. Although susceptibility to such tactics will vary from industry to industry, and even company to company, a government that can garner the support of NGOs, and even the support of other states, may be in a better position to negotiate with an investor.

When will a state decide to adopt one or more of these strategies? The likelihood of success of a given strategy will be an important factor, as will be the anticipated consequences of the strategy (e.g. financial and reputational costs). It would also seem logical that states will also consider the consequences of settling with an investor. If a conflict concerns an issue that is politically salient, for example, access to drinking water, it is more likely that a government will defend the case in arbitration than if it deals with a less volatile subject such as the protection of biodiversity. Governments may also fear the loss of revenue from other areas (e.g., ecotourism) or a loss of credibility on the domestic or international stage if they are seen to be 'giving in' to the demands of foreign corporations. Therefore, domestic politics will be a significant factor in any decision.

It can be hypothesized that states confronted with a threat of arbitration that are considering how to proceed have three main 'decision filters', based on the potential:

- Outcome of the case if it proceeds to arbitration (or is challenged in the courts);
- Consequences of arbitration (or litigation to challenge proceedings); and
- Consequences of a settlement that includes compensation or policy change.

Each filter is based on government perceptions, which will vary from state to state. For example, a government that has had previous negative experience in

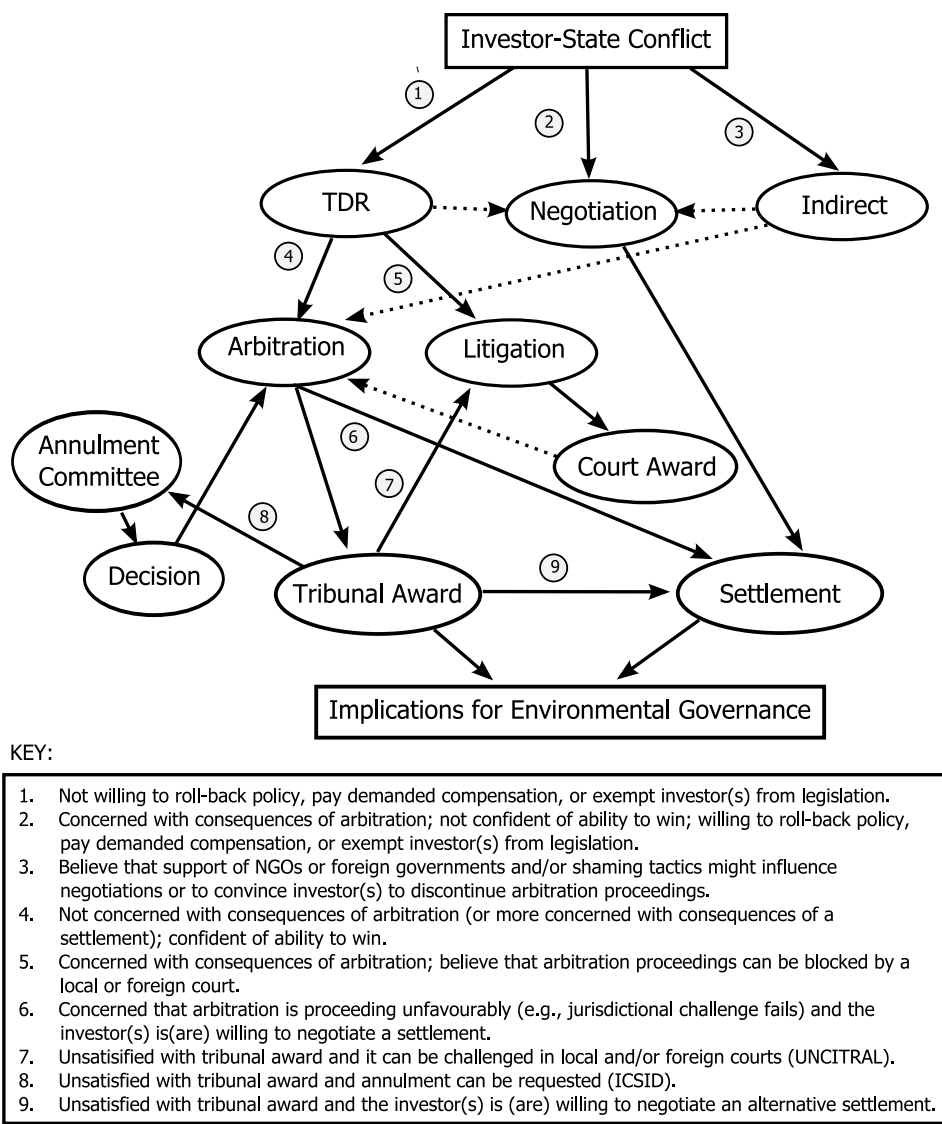


Figure 8.1: State Strategies

Table 8.3: Government Decision Filters

<i>If the government perception of the potential:</i>	<i>which depends on:</i>	<i>is:</i>	<i>then it will likely apply the strategy of:</i>
<i>Outcome of Arbitration/Litigation</i>	Access to information and expertise; previous experience with arbitration; similarity of case with others that have been decided in arbitration...	Win	Arbitration and/or Litigation
<i>Consequences of Arbitration/Litigation</i>	Availability of in-house expertise; cost of outsourcing; complexity of issues in case (estimation of likely duration of proceedings); GDP/government budget; damages claimed by investor; ideology (concern about reputation); level of FDI inflows; overt pressure from investment community; diplomatic pressure...	Lose (or uncertain)	Negotiation and/or Indirect Measures
		High	Negotiation and/or Indirect Measures
<i>Consequences of Settlement</i>	Financial cost of compensation; other financial considerations (e.g. cost to remediate environmental damage, injury to other industries); ideology (concern about credibility); political salience of the issue in dispute; public awareness of dispute; international commitments (e.g. MEAs); involvement of NGOs...	Low	Arbitration and/or Litigation
		High	Arbitration and/or Litigation
		Low	Negotiation and/or Indirect Measures

arbitration might perceive the outcome of a case differently than one which has had no past experience. A state with significant financial resources will perceive the consequences of arbitration differently than a poor country. Ideology can also be a significant factor, as evidenced by the current movement in several Latin American countries: leaders such as Hugo Chavez are not particularly preoccupied with their country's reputation amongst investors. Finally, a government facing a pending election will likely be especially concerned with the consequences of settlement in a politically sensitive conflict.

Running a decision through all of these filters may point to one obvious solution, or may instead suggest conflicting strategies (see Table 8.3). For example, if a government perceives that it will lose in arbitration, and that arbitration will be costly in both financial and reputational terms, but that a settlement will produce little in the way of political repercussions, then the obvious choice is to negotiate with the investor. On the other hand, if a government perceives that it will lose in arbitration, and that arbitration will be costly in both financial and reputational terms, but that a settlement will produce significant political repercussions (e.g., loss in pending election), then the state may choose to arbitrate. These filters are complex and therefore only have explanatory, rather than predictive, value.

8.3.2 The Value of a Neo-Gramscian Approach

The relationship between the institution of investment protection and environmental governance has most often been studied from a legal perspective. Legal research on the topic is valuable and necessary, but there is also a need for greater consideration of the political side of conflicts between investors and states. This study has shed light on the significance of the threat of arbitration, an issue that would not attract attention from legal researchers who are predominantly interested in the interpretation and development of legal norms and rules.

When addressing the politics of investor-state conflicts, a number of approaches could be adopted. In this study a neo-Gramscian perspective was chosen. While many of the critical insights in this study could have been made without the use of neo-Gramscian terminology, the framework lent cohesion to the broad range of topics and cases that were addressed. Perhaps the most relevant neo-Gramscian observation, in relation to this study, is the emergence of the new constitutional-

ism. The new constitutionalism encompasses the structural and ideological constraints that are imposed on states by the transnational historic bloc and helps to explain why they are voluntarily ceding authority to tribunals. It also captures the way in which these constraints can be ‘locked-in’, resulting in a loss of democratic accountability.

The transnational focus of the neo-Gramscian perspective was also crucial in this study, particularly in the analysis of the second-order cases. If the state had been viewed as a unit, key insights on the way that domestic politics factor into government responses to threats of arbitration would have been missed.

The approach also called for a critical assessment of the role of NGOs in the institution of investment protection. The concept of *transformismo* helped to explain the changing nature of NGO involvement in, and perspectives on, the institution of investment protection. The analysis suggests that further critical research on the impact of *amicus curiae* briefs is required in order to determine whether certain NGOs are key counterhegemonic voices or have instead been co-opted by the transnational historic bloc.

This study has benefited from the application of neo-Gramscian insights and it has also, in turn, contributed to neo-Gramscian scholarship. While the major writings in the field are largely focused at the macroeconomic and macropolitical level, this study focused on one specific area and gave considerable attention to domestic interactions. The study also drew links between neo-Gramscian theory and other theories/hypotheses (e.g. regulatory chill, political cover). These hypotheses and theories are consistent with neo-Gramscian thought and both enrich and help to operationalize a neo-Gramscian framework.

8.3.3 Avenues for Further Inquiry

In recent years, interest in the relationship between investment law and environmental law in academia has increased significantly. This interest has been focused largely on three fora: (1) disputes that have taken place within the context of the NAFTA’s Chapter 11; (2) the failed negotiations for a MAI under the auspices of the OECD; and (3) the ongoing attempts to develop a similar agreement in the WTO. Attention now appears to be turning to the vast multitude of BITs, which mainly affect countries in the developing world.

Still largely neglected in discussions of investment and environment are unilateral commitments to investment protection made by developing country governments, through either national legislation or contracts with individual investors. These commitments are unilateral in the sense that they are made by a host state without a reciprocal arrangement, be it bilateral or regional, with the investor's home state. As shown in this study, such unilateral commitments may equal, or even surpass, those commitments made in international treaties and may have significant implications for the regulation of the environment. Stabilization clauses and agreements, in particular, constitute an emerging and complex issue in international investment law, and to date have largely escaped scrutiny. Further research is required on commitments to stability, particularly in environmentally relevant sectors such as resource extraction. Unfortunately, such research will be greatly complicated by the lack of access to information concerning state contracts.

While greater attention should be paid to unilateral commitments, there is also, of course, a need to keep track of emerging developments in IIAs. In particular, it will be important to assess pending and new cases in investment arbitration to determine whether an informal system of precedent has emerged with regard to the key regulative norms and rules of investment protection, and to assess the implications of evolving interpretations. Special attention should also be given to any cases that develop under the new generation of IIAs that contain clarifications of the key regulative rules and norms. These cases will provide some indication as to the strength of these reforms.

Procedural reforms should also be more closely scrutinized. Now that third party participation has occurred in several environmentally relevant cases, a new area of research has opened up. The focus of research in this area should be on the impact that *amicus curiae* briefs have on the outcome of specific cases, as well as the broader awareness-raising value that they may provide. Also required is an assessment of how the participation of third parties affects perceptions of the legitimacy of international investment arbitration.

Finally, while this study has provided a first glimpse into the complexities of investor-state conflicts that are resolved in the shadow of investment protection, there is a need for much more research in this area. Unlike tribunal awards, settlements that result from a threat of arbitration can include policy roll-back or non-

implementation. They can also set dangerous precedents, encouraging investors to threaten arbitration whenever an unfavourable policy or decision emerges. It is recommended that future research projects delve even further into the domestic political interactions that result from threats to arbitrate. Longer-term studies could also assess the impacts on policy-making following the resolution of a conflict. Research in this area will continue to be hampered by limited access to information, at least in the near-term. Nevertheless, this study has shown that empirical research can be fruitful and can contribute significantly to an understanding of the complex relationship between investment law and environmental governance.

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